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# COMPETITIVE ISSUES IN THE CABLE TELEVISION INDUSTRY

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## HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST,
MONOPOLIES AND BUSINESS RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

ON

THE CONCERN OF POSSIBLE COMPETITIVE PROBLEMS WITHIN THE CABLE TELEVISION INDUSTRY

MARCH 17, 1988

Serial No. J-100-55

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# COMPETITIVE ISSUES IN THE CABLE TELEVISION INDUSTRY

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THURSDAY, MARCH 17, 1988

U.S. SENATE,
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES
AND BUSINESS RIGHTS,
COMMITTEE ON THE JUDICIARY,
*Washington, DC.*

The subcommittee met, pursuant to notice, at 9:35 a.m., in room SD-226, Dirksen Senate Office Building, Senator Howard M. Metzenbaum (chairman of the subcommittee) presiding.

Also present: Senators Thurmond and Humphrey.

## OPENING STATEMENT OF HON. HOWARD M. METZENBAUM, A U.S. SENATOR FROM THE STATE OF OHIO

Senator METZENBAUM. The hearing will come to order.

Cable television has brought enormous benefits to consumers. It has provided American families with access to an incredible diversity of programming. It has allowed community organizations and local governments access to the airwaves.

But while consumers can benefit from cable, they can be treated unfairly by a cable monopoly. Like any other area of the economy, if competition disappears or is foreclosed, the consumer will ultimately pay a price.

From today's vantage point, it is possible to look ahead to see potential problems to consumers. First, since cable rates were deregulated 16 months ago, cable rates have zoomed upward. In some places, deregulation has led to increases of 200, 300, or even 400 percent. For example, in Denver before deregulation consumers could buy services for $2.50. Now the smallest monthly check they can write is for $13.95.

In Russell, OH, rates jumped from $5 to $16, and in Fairfax County, VA, cable subscribers lost six channels if they did not increase their monthly payments to $3.07 to $12.95.

The message that is coming through loud and clear is that perhaps we should revisit our decision to deregulate cable. I can tell you that if rates continue to spiral upward, this Senator will urge that Congress do just that.

Since Congress deregulated the cable industry, technology has continued to advance, offering new and expanded competition to cable. I am extremely bothered by reports that the cable industry is freezing its potential competition out of the market by refusing to provide programming or by making programming available only at artificially high prices.

Once a family subscribes to cable, access to free TV is practically limited to broadcast stations carried on cable. Cable interests will increasingly compete with broadcasters for viewership and advertising revenue.

I am concerned that while cable serves as a gatekeeper to the family TV set, it does so in a way that preserves and protects our valuable national resource of free TV. I am troubled, and I think that millions of Americans that cannot afford to subscribe to cable, should also be troubled to see reports that one day a consumer might have to subscribe to cable to see the World Series, the Academy Awards, or the Summer Olympics.

These are complicated issues, not susceptible to quick and facile solutions. I look forward to discussing with today's witnesses how we can best preserve the benefits cable has provided and retain the vigorous and competitive market to protect consumers today and in the future.

I think it should be understood that this hearing today is not a precursor to the introduction of legislation. This hearing today is to sound a warning and an indication of concern to the cable industry that they have grown too powerful. While cable is a medium that the American people are using more and more, and are pleased to do so, but that there can be an abuse of the rights which the cable operators have in this country.

Congress went out of its way to let down the bars, so that municipalities could no longer regulate the rates. Cable has a responsibility. Free TV has a responsibility. I would say that we would hope that at the conclusion of these hearings, that there might be some positive movements forward, by the industry, to avoid the necessity of Congress interceding.

It is this Senator's view that under the best circumstances Government should not be involved. An industry that is as powerful as this one, and many other industries as well, should look at their problems themselves and say maybe there are some changes that need to be made before the Congress of the United States has to direct its attention to the problem and come down with a legislative solution.

We are very pleased to have with us today the very distinguished ranking member of this committee, Senator Strom Thurmond.

## OPENING STATEMENT OF HON. STROM THURMOND, A U.S. SENATOR FROM THE STATE OF SOUTH CAROLINA

Senator THURMOND. Thank you very much, Mr. Chairman.

Mr. Chairman, there are many issues which we will hear about today concerning possible competitive problems within the cable television industry. These problems affect not only the cable industry, but also other noncable distributors and the viewing consumers.

In fact, just several months ago, we held a hearing concerning the contractual arrangements between the NFL and cable networks for the broadcast of regular season football games, including some Monday night games. One of the issues raised was the extent to which the broadcast of these games, previously on free television, should be available only on pay television.

Cable television has grown by leaps and bounds since its introduction in 1948 and, by most accounts, can no longer be considered a fledgling industry. According to one recent report, 43 million homes, or 50 percent of those homes which can subscribe to cable, do so. This same report states that in 1952 there were 70 community antenna television operations, the precursor of cable, with approximately 200 subscribers per system.

Today the cable industry is dominated by major companies known as multiple system operators, or MSO's, with approximately half of all cable subscribers subscribing to one of the 15 largest MSO's. Furthermore, the number of program services has grown from HBO and WTBS in 1975 and 1976 to about 45 program services now offered by way of satellite on a pay basis.

Mr. Chairman, I welcome the opportunity to hear from our witnesses today, and to explore with them the problems and possible solutions which confront this very exciting technology. Although it is no longer an infant or fledgling technology, it is a growing technology, and as such, it is bound to experience those problems associated with rapid growth.

I want to thank our witnesses for appearing today. I have a conflict with the Armed Services Committee, some secret information about what is going on in Central America, and I am going to have to leave in a little bit, but I assure you I will read this testimony and find out just what you have to say.

I want to thank you, Mr. Chairman, for conducting this hearing.

Senator METZENBAUM. Thank you very much, Senator Thurmond.

Our first witness today is William Finneran, chairman of the New York State Commission on Cable Television from Albany, NY.

The Chair wishes to announce that we have a 5-minute rule for witnesses. We have 13 witnesses today, and if we are going to be able to hear all of them and get some questions in, as well, we are going to have to adhere very strictly to the 5-minute rule. We will include your entire statement in the record.

Mr. Finneran, happy to have you with us, sir.

## STATEMENT OF WILLIAM FINNERAN, CHAIRMAN, NEW YORK STATE COMMISSION ON CABLE TELEVISION, ALBANY, NY

Mr. FINNERAN. Thank you, Senator Metzenbaum, Senator Thurmond.

I deeply appreciate your invitation to be with you today.

In Ellenville, NY, a once-flourishing business came to an end. A plant shut down, laid off the workers, closed the doors. Why? There was no longer a demand for the product it manufactured. What was that product? That product, for which there was no longer a demand, was the rooftop antenna.

Someday, in the not-too-distant future, a kid is going to be going through the Smithsonian Institute and he is going to stare over at an exhibit and he is going to ask: "What is that, Mommy?" It is going to be a rooftop antenna.

Today, American families get their television pictures two ways, over the air via broadcast, or this cable wire coming into their home. Most Americans, more than 50 percent, get their television pictures from this wire coming into their home.

In other words, we are moving into that age of the "single-wire dependence." It is happening.

In my opinion, over-the-air broadcasting, as a significant medium to reach the American people, will be extinct by the end of the century. And that is conservative. I do not think there is any question about that.

This single wire will be a family's sole interface to the whole universe of programmed entertainment and information and video news, all coming through this single wire. So who controls the wire, who determines what signals are or are not, transmitted on the wire, what role Government plays in reasonable oversight over that, these are public policy questions that are of profound importance and their resolution will shape our future.

In enacting the Cable Act in 1984, Congress deregulated basic rates in areas where there was "effective competition." Congress delegated the definition of what is "effective competition" to the FCC, saying that "The FCC should consider the number of services provided, compared with the number of services available from alternative sources." That was the commission of the FCC.

The industry had convinced the Congress that its growth was stymied by a melange of "alternative technologies": DBS, MDS, MMDS, STV, SMATV. There were more alternative technologies than there were brands of alphabet soup. Regulation embodied in the Cable Act was necessary for cable to prosper, to meet this competition.

Let me say it was a myth, that those technologies were has-beens and never-weres. I think it can be reduced to a single question. There are 7,000 cable franchises across the United States serving 20,000 communities in these United States. I think Mr. Mooney or a spokesman for the industry ought to be challenged to name one community across the length and breadth of the United States where an alternative technology, any of those, has made any inroads or could compete successfully against this wire. It is just not so.

An awesome number of channels that can be transmitted through this wire. In New York—forget the over-the-airs which are all included—you are talking here MTV, ESPN, Madison Square Garden, USA, Arts and Entertainment, Nickelodeon, Superstation, CBN, Cable Value News, Headline News, Financial News, Black Entertainment Network, Discovery Channel, Learning Channel, Daily News Network, C-SPAN, on and on and on. This can carry 77 channels into the home.

So the idea of the FCC that a few off-the-air channels, which are given free in the cable, can compete against cable is just a preposterous notion. It is an Alice in Wonderland fairy tale.

To the question—is cable a monopoly?—one need only ask any of the 45 million American families who enjoy cable. They know that the gamut of their choice is twofold: take it or leave it.

But having said that, that cable is a monopoly, let me say that in this commission's view, a prospering monopoly can best benefit the public. It is the most efficient system. To achieve public policy goals of diversity in programming, of universal access, cable needs a healthy revenue stream. I think it can be a benevolent monopoly and the potential to fulfill the public interest is very real. For example, we require, and the Cable Act requires poor neighborhoods to be wired.

The constitutional point—that cable has the right to determine what goes on that wire, to have editorial jurisdiction over all those channels, to say if I own the cable outlets in Carolina, and I think CBS is soft on communism, I can take CBS off that channel, or I can preclude the Black Entertainment Network, or I can say fundamentalist ministers should be on or should not be on, depending on the operator's fancy, that concept of the Constitution that says, in effect, that the cable operator has the unfettered right, without any constraints, to determine what comes into the home of the American family—I just think is chilling and endangers the first amendment rights of all Americans.

I have hardly begun my testimony. I understand the time constraints. I think if cable rates become excessive, Congress should revisit, particularly the renewal provisions of the act.

Finally, if I may, one final point: broadcast and cable. Senator Metzenbaum has drawn attention to the endangerment of broadcast. They have lived to mutual advantage, in a synergistic kind of relationship. On the one hand, there was the compulsory license that cable enjoyed. And then, on the other hand, there was the mandate to carry the local broadcast system.

But with the mandate now being declared unconstitutional, with that "must carry" having been demised, I think that if the Congress does not redress that imbalance which now exists, that the broadcaster will undergo a sweep all right. He will be swept into history in just a few short years.

I think that is an important matter that Congress ought to give its attention to.

I thank you, Senator, for the honor and privilege of being with you.

Senator **Metzenbaum**. Thank you.

Let me first ask you, Mr. Finneran, do you think that the FCC definition of effective competition pretty much abrogated the intent of Congress?

Mr. **Finneran**. I believe, and believe it or not, the Department of Justice claims that, that the intent of Congress was real alternatives. There are no real alternatives. No technology exists that can compete with 77 channels being brought through this wire into the home.

The key point is the penetration. Already 6 out of 10 American families, given the opportunity to have cable, have subscribed. That rate will go to 70 and when the rate escalates, what happens in effect, the over-the-air broadcast becomes redundant. The fact is that broadcast, if it survives, will get to the home through the wire.

In effect, I think that the need for a local affiliate in every community evaporates because it becomes a dinosaur, a needless appendage, to have a local broadcaster. After all, the cable company can receive the network signals off the satellite just as well as the local broadcaster. Why, then, should the network pay its affiliates across the country hundreds of millions of dollars needlessly when it can, with the local cable operator, distribute its network signal?

I am saying there is a real danger for the survival of broadcast.

By the way, I think they ought to compete. You see cable advertising revenues going in 1980 from $50 million to $1.5 billion this coming year. That is at the expense of the networks. I do not think there is anything wrong with that. Indeed, revenues coming into cable from alternative sources than the consumer will lessen the upward pressure on cable rates to the consumers in Ohio.

And so there is some element of that advantaging the public. But the point is that broadcast at least ought to be assured of survival by being given a place on the cable system.

I would recommend one approach whereby there would be long-term agreements—99-year leases for $1 a year—to assure that stations will get on the cable system and will have permanence on that system, and will not be discarded 10 years down the road when 90 percent of your transmission is into the home via the wire.

Senator METZENBAUM. What has happened to cable rates in New York since deregulation?

Mr. FINNERAN. Cable rates, since deregulation, have escalated. We have some instances of 107 percent. I note the examples, Senator, that you cited in your initial words. Let me say I am not convinced that going from $2 to $14 is outrageous and unreasonable on the cable company's part.

The fact is that what has happened was something that was unexpected. As a result of the rate deregulation, something else happened, which I think savages the public interest, and it has nothing really to do with the rates. It was the perception of cable as a cash cow, and indeed to some extent the reality.

And so you have systems being sold at enormous prices. It used to be $600 per subscriber was the going rate. Then $1,000. Then $1,500, $2,000. I met a fellow here in Washington last night from Laredo, TX. His system was just sold for $2,300 a subscriber.

Many of those acquisitions, and that is what has happened over the last several years in these enormous acquisitions, the mom and pop cable systems evaporating, the acquisition by the few MSO's, as you indicated, to acquire the systems. The number of systems in New York has diminished drastically.

But the point is that with systems selling at over $2,000 a subscriber, and most of that being debt generated—in other words, the companies will go into debt to buy those systems. So if you would look at a subscriber——

Senator METZENBAUM. Mr. Finneran, I have a number of questions for you, but if you answer each one as lengthy, I am afraid I will never get a chance to ask them all.

Mr. FINNERAN. I apologize. I will be more efficient with my words.

Senator METZENBAUM. Thank you. It is the Senator and I who have the prerogative to filibuster.

Let me ask you, if cable is a monopoly at the local level, does it really matter to the consumer whether there are 5 or 500 cable operating companies nationwide?

Mr. **Finneran**. Of course not, and you hit on one of the great fallacies. It does matter in that as the industry evolves to half a dozen giants, they have marketing power that is enormous in getting their product a lot cheaper than the smaller systems. But to each individual American family, those 45 million Americans, in their particular area is a monopoly and the only thing that is meaningful to that American family is the fact that they have no alternative.

One interesting thing, one town in New York gave the franchise to two operators and they each started wiring from the opposite end of the town. When the two areas abutted, where they each had wired, they stopped wiring. They did not continue the wiring into neighborhoods that had been wired by their competitors.

I think reasonable business prudence says you should not. I think that is economically suicidal and inefficient. The idea of overbuilds is nonsense. Overbuilds are unstable economically and do not survive. They survive for a little while, for some little competition, but one or the other bellies up and bankruptcies.

It has happened in Phoenix and it has happened everywhere else that you have tried overbuilds.

Senator **Metzenbaum**. Briefly, I wonder if you want to comment on the impact or the fact that the New York Yankees have given exclusive rights to carry 100 of their games this summer on cable. And as I understand it, there is very little cable outside of Manhattan. That means that Yankee games will not be available to millions of hometown fans. But as a matter of fact, it will not be available unless you get it on cable.

I can see a movement starting to put the major sports events of this country on cable and they are not being on free television. Do you have a brief comment on that?

Mr. **Finneran**. There clearly, as one growing up and rooting for the old Brooklyn Dodgers and looking forward avidly to it, I think the trend you are citing, Senator, is very real. There is a sadness to it.

In the Bronx, we have cable just getting started. Senior citizens who look forward to their home team right in the center of the Bronx, the Bronx bombers, the Yankees, and cannot see them. There is not even cable there yet to subscribe to. There is a sadness.

Families who have never seen any of the last dozen bouts or so of the heavyweight champion of this world, Mike Tyson. They are all on cable. That is the power of the technology, the awesome power of this wire.

The networks simply cannot compete to offer, for example, a heavyweight championship fight, the kinds of dollars that cable can afford to do. The competition is a very real one.

What I am saying is that what you cite will happen unless there is some reasonable governmental oversight and regulation.

Senator **Metzenbaum**. Senator Humphrey, happy to have you with us.

Senator **Humphrey**. Thank you, Mr. Chairman. I have no questions.

Senator **Metzenbaum**. Thank you, very much.

Thank you very much, Mr. Finneran.

Mr. **Finneran**. Thank you, Senator. I deeply appreciate the honor of being with you.

[The prepared statement of Mr. Finneran follows:]

# TESTIMONY

# OF

# WILLIAM B. FINNERAN
CHAIRMAN
NEW YORK STATE COMMISSION ON CABLE TELEVISION

In Ellenville, New York, a once-flourishing manufacturing company closed the doors of its plant and laid off its work force. "The demand for our product is fast disappearing", said management. The company was Channel Master. The plant in Ellenville produced the rooftop antenna. In the not-too-distant future, a child visiting the Smithsonian will point to a rooftop antenna. "What is that?", he will ask his mother.

Today, more than 50% of American families receive television signals by cable; it has been a delayed journey of promises and postponments, but we are well into the era of "single-wire dependence".

Indeed, in my opinion, "over-the-air" broadcasting, as a significant transmission medium to the populace at large, will be extinct before the end of the century.

That single wire will be virtually an American family's sole interface with the outside universe of video news, programmed entertainment and information. Who controls what is, or is not, transmitted over that wire, the nature of that control, and the presence or absence of reasonable governmental oversight, are profound public policy questions; how they are resolved will shape our future.

In enacting the Cable Communications Policy Act in 1984, Congress deregulated basic cable rates in markets where "effective competition" existed. Congress delegated such definition to the F.C.C. as indicated in the Committee Report:

> In determining whether (a) cable system is subject to effective competition for the purpose of regulation of basic cable service, the F.C.C. should consider the number and nature of services provided, compared with the number and nature of services available from alternative sources and, if so, at what price. Emphasis added.

The industry had convinced the Congress that a melange of "alternative technologies" -- DBS, MDS, MMDS, SMATV, STV, etc.,

etc. -- threatened its growth, and the deregulation embodied in the Cable Act would provide "a level playing field" on which to compete effectively.

Question: There are over 7,000 cable franchises serving perhaps 20,000 communities in the United States. Name one community where any of the "alternate technologies" effectively competes with franchised cable? Or has garnished even a 5% market share where franchised cable is available?

Is cable a monopoly? Forty-five million American families know the answer to that, know that the gamut of choice is two-fold: "take it" or "leave it".

But the term "monopoly" here need not be construed in the pejorative sense; a prospering monopoly has the potential to best serve the public interest. To achieve the goals of public policy -- diversity in programming and universal service -- cable systems need a healthy revenue stream.

The Cable Act requires that poor neighborhoods be wired, and gives strong legal underpinning to the right of state and local governments to require PEG (public, educational and governmental) programming, which assures a degree of diversity and, one hopes, a more enlightened citizenry.

Thus, the intention of the Cable Act was to achieve a semblance of balance between the public obligations imposed on the cable operator and the de facto market exclusivity afforded the operator by the franchise.

The federal law was no sooner enacted than some cable operators challenged any and all obligation flowing from the Act.

New-found First Amendment rights as a "speaker" granted permanence in the community, and a supposed immunity from municipal review at renewal time. Further as an "electronic publisher", the cable operator is claimed to have unfettered editorial control over each and every channel on his system.

The adoption of this viewpoint would be a chilling day for America. A cable operator, if he thought CBS was "soft on Communism", could just take CBS off his system; or find no available channel for the Black Entertainment network; or put fundamentalist preachers on, or off -- whatever the operator's fancy -- the cable system. What is claimed is the right to be sole arbiter of what American families see or do not see, and such view savages the treasured First Amendment rights of every American.

A cable system is not a newspaper. It is much more like a single newstand with an exclusive license to serve a city, town or village. Given a single-source de facto monopoly, the unilateral right to determine what papers or magazines the citizens will be allowed to buy, puts the public's First Amendment rights at risk.

With regard to the Cable Communications Policy Act:

- If basic rates become excessive, municipalities should have the right to establish an "entry level" of service at a regulated rate.
- The Act has emasculated accountability to local governments; Congress should consider revisiting the renewal provisions of the law to assure an acceptable level of responsiveness to the community.
- There should be a reaffirmation by Congress that the states, and/or their municipalities, have the right to inspect for compliance with state or federally set technical standards for safety and picture quality.

Finally, maintaining diversity of communications is clearly in the public interest. Historically, cable television and broadcasting have enjoyed a synergistic relationship, and a balance of sorts achieved in that the liberties allowed the cable operators by the "compulsory license" have been tempered by imposition of the "must carry" mandate.

With the demise of "must carry", that delicate balance has been upset. If Congress or the F.C.C. fails to restore that balance and takes no remedial action, the local broadcaster will be "swept" into history in a few years.

I strongly recommend that long-term agreements -- perhaps ninety-nine year leases on the cable system at $1 per year -- be considered by the Congress.

I thank you for the privilege of sharing my thoughts with you on these important issues.

Senator **Metzenbaum**. Our next witness panel consists of Mr. James Theroux, on behalf of the Wireless Cable Association of Cleveland; Mark Foster, chairman and co-chief executive officer of The Microband Companies, NY; George Kocian, spokesperson for the Home Satellite Television Association of Tiverton, OH; and Thomas Burke, president, United Satellite Industry Association of North Little Rock, AR.

Mr. Theroux, we are very happy to have you with us this morning, and in 5 minutes I want you to tell us why the inability to obtain product is threatening your industry, which is I understand the thrust of your concern.

## STATEMENT OF A PANEL CONSISTING OF JAMES THEROUX, WIRELESS CABLE ASSOCIATION, CLEVELAND, OH, ACCOMPANIED BY NICK ALLARD, COUNSEL, WIRELESS CABLE ASSOCIATION; MARK FOSTER, CHAIRMAN AND CO-CEO, THE MICROBAND COS., INC., NEW YORK, NY; GEORGE KOCIAN, SPOKESPERSON, HOME SATELLITE TELEVISION ASSOCIATION, TIVERTON, OH; AND THOMAS BURKE, PRESIDENT, UNITED SATELLITE INDUSTRY ASSOCIATION, NORTH LITTLE ROCK, AR

Mr. **Theroux**. Thank you, Mr. Chairman, and Senator Humphrey. This is Nick Allard, who is counsel to the Wireless Cable Association.

My name is Jim Theroux. I represent the Wireless Cable Association, a group of companies that stands ready to bring consumers all the benefits of competition, lower prices, better service, wider selection. We do it with an advanced technology that can bring up to 33 television channels through the air to a tiny antenna on your roof.

We seek to compete with cable and I can understand Mr. Finneran not understanding that such a thing is possible, but this is a new technology that seeks to compete with cable, but not to destroy it. The economics, the unique economics of our business allow us to be viable with only a small share of the cable market, much like MCI has a share of the long-distance telephone market.

Although we seek to compete with cable, there are impediments to our serving consumers. These impediments have the potential to kill our wireless cable industry and consumers will be left holding the bag, paying monopoly prices for cable and being stuck with the take it or leave it attitude of a monopolist.

These impediments are refusals to deal with us by certain key programming services, such as HBO, Disney, Showtime, USA Network, and on and on and on. These satellite programming services are like milk, eggs, or bread to a grocery store. Just as you have Safeway and 7-11 that have very different products and serve the consumer in different ways, if either one of them could not get milk or eggs, he would be a dead duck.

That is the situation that we face. Without the milk and eggs of satellite programming, we will die and cable's monopoly will be perpetuated.

Now cable does not like that word monopoly. They hide from it like a vampire hides from the daylight. But I can tell you that if you go to my hometown of Cleveland and walk down the street, you are not going to find anybody who has any questions about whether cable is a monopoly.

Cable will tell you that they are part of a broad market that includes theaters and VCR's and broadcasting, and that these things exert a competitive discipline on their prices. But I think you can see the superficiality of that argument if you think about another product like food. Think of the broad market of food in which you have eating at home, that exerts a competitive discipline on restaurants. But would consumers be well served and would Congress tolerate it if one company controlled all the restaurants in a city? Does anyone doubt what would happen to restaurant prices and to quality of service, even if people still had the option of eating at home?

That is the situation that we face in cable.

Now fortunately, there is restaurant competition. And also now fortunately, there is a new technology that Mr. Finneran is not aware of probably because it is so new. But it started in Cleveland, OH, 2 years ago. And that new technology does have the potential to compete with cable, so should not consumers have the benefit of that? Do not consumers deserve having a choice in how they get satellite programming.

Senator **Metzenbaum**. What is the concept of new technology?

Mr. **Theroux**. The concept is that we send through the air, up to 33 channels to a tiny antenna on your roof. It is an advanced new technology that, as I say, began 2 years ago in Cleveland.

Now fortunately, in Cleveland we were able through lawsuits and other means to get enough programming to start up in business. And we have got now thousands and thousands of satisfied customers. These people like the programming we give them. But what they really love is our prices. For $9.95 our basic service, which includes the remote control flicker, is available to them. If you go out into the suburbs of Cleveland and get equivalent service, you pay about $18.

So we are better in price and we are also better in service. We do surveys of our customers and theirs, which find us significantly superior to cable because we do things like answer the phone more promptly; we put a rose on top of your TV when we install the service. So I have got a great technology——

Senator **Metzenbaum**. Is that like a death rose? [Laughter.]

Mr. **Theroux**. I hope not. It is not a funeral, I hope.

Senator **Metzenbaum**. Please wind up.

Mr. **Theroux**. I will. So what is the problem? The problem is the cable monopoly. It is nothing new. Broadcasting tried to shut out cable when it was getting going, and now cable is trying to use HBO and programming services like it to perpetuate their monopoly and to halt progress. They have got these local monopolies that are horizontally concentrated now. They vertically integrate into programming. That gives them the ability to deny access of HBO and Disney and all these others.

So until the Department of Justice or the Congress does something, I feel that we are going to have this problem. And I think these hearings are a good step in the direction of solving them. I thank you and your colleagues for your interest.

[The prepared statements of Mr. Theroux follow:]

# Statement
# of
# James M. Theroux, Chairman
# Regulatory Affairs, Wireless Cable Association

Before the Antitrust, Monopolies and Business Rights Subcommittee
Senate Committee on the Judiciary

Good morning Mr. Chairman. My name is Jim Theroux and I represent the Wireless Cable Association, a group of companies that is ready to bring consumers all the benefits of competition: lower prices, better service, and wider selection. We do it through an advanced technology that sends up to 33 channels through the air to a tiny antenna on your roof.

We don't seek to destroy cable, any more than MCI destroyed AT&T. The unique economics of our business allow us to be viable with only a small share of the cable market, equivalent to what AT&T's competitors have achieved.

But some severe impediments are preventing us from serving consumers. These impediments will kill our budding wireless cable industry, and the consumer will be left holding the bag, paying monopoly prices for cable, and being stuck with the monopolist's take-it-or-leave-it attitude.

These impediments to competition consist of refusals to deal by satellite programmers such as HBO, Showtime, Disney, USA Network, and many others. These programming services are to cable what milk, eggs, and bread are to a grocery store. Without milk and eggs, no competitor to cable will have a chance of surviving in the retail marketplace.

Of course, cable tries to hide from the word monopoly, just as a vampire hides from the daylight. I'm not an economist, but I guarantee you that the average guy in my hometown of Cleveland has no doubts that cable is a monopoly. But cable will try to tell you it is part of a broad video market in which theaters, VCR's and broadcasting exert competitive discipline on its prices.

The superficiality of this point of view becomes apparent when one thinks of some other products. For example, you might say that there is a broad market for food in which eating at home restrains the prices that restaurants charge, just as, cable says, broadcasting restrains its prices. But would consumers be well served and would Congress tolerate it if ONE COMPANY controlled all the restaurants in a city? Does anyone doubt what would happen to restaurant prices and services, even though people would still have the option of eating at home?

Fortunately, consumers have the benefit of restaurant competition. Now that there is a technology available to provide cable competition, why shouldn't consumers have that too? Don't they deserve a choice?

That new cable technology is more than just theoretically available. It actually got off the drawing boards and into the real world two years ago in Cleveland, Ohio. In Cleveland, my company was able to get into business because conventional cable was not established, and through lawsuits and other means we got enough programming services to attract over 20,000 customers. Those customers like the programming I deliver, but they LOVE our prices: our Basic service, including remote control, costs $9.95. Cable charges about $18.00 for its equivalent. And in service quality our surveys show us beating cable by a significant margin by doing things such as answering our phones more promptly and adding touches such as a fresh rose at the time we install the service.

So, I've got a great technology, terrific prices, excellent service; my customers like me, but they ask me certain nagging questions: Why don't we have HBO; why don't we have Disney; why don't we have USA Network, the Weather Channel, and on, and on. They blame me. Yet here I sit with money in the bank ready to pay for the services.

But just as the railroads tried to protect their monopoly from truckers, and broadcasters tried to protect themselves from cable, now conventional cable is using HBO and others to halt progress and protect its monopoly. The cable industry is extending its newly deregulated power through horizontal concentration of retail monopolies which then vertically integrate into ownership of programming (e.g. CNN). This vertical integration allows big cable to deny access to programming to would-be competitors. And consumers will continue to suffer the consequences until Congress or the Department of Justice takes action. For this reason, Mr. Chairman, we believe that these hearings are an important step in the right direction, and we appreciate your leadership.

Mr. Chairman, I would request that these brief remarks be supplemented by including my formal, prepared testimony into the record of this hearing. I would, of course, be happy to respond to your questions.

Thank you very much.

# TESTIMONY OF JAMES M. THEROUX
REGULATORY AFFAIRS CHAIRMAN
WIRELESS CABLE ASSOCIATION
Before The
UNITED STATES SENATE
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS

March 17, 1988

Mr. Chairman, members of the Subcommittee, on behalf of the Wireless Cable Association ("WCA"), I thank you for this opportunity to testify today. With my testimony, I hope to introduce and explain more fully the state-of-the-art satellite programming delivery system known as wireless cable and to enumerate the various anticompetitive practices by coaxial cable operators and programmers that threaten to destroy wireless cable as a competitor in the retail market for satellite-delivered programming. In the future, the WCA will stand ready to provide any assistance that this Subcommittee might require as it monitors the competitive health of the satellite-delivered programming marketplace.

## INTRODUCTION TO THE SATELLITE PROGRAMMING DELIVERY SYSTEM OF WIRELESS CABLE

The wireless cable industry consists of firms possessing licenses to deliver programming taken down from satellites and re-transmitted on microwave frequencies to tiny antennas on private homes and multiple unit dwellings. The wireless cable delivery system eliminates the costly network of wiring required by traditional coaxial cable franchises. Instead, a wireless cable operator uses the Super High Frequency ("SHF") portion of the radio frequency spectrum, *i.e.*, the spectrum above the Very High Frequency

("VHF") and Ultra High Frequency ("UHF") allocated to broadcast, to transmit satellite programming from a central point directly to a tiny antenna mounted on the subscriber's roof top. At the roof top, the SHF signals are coupled with the locally available VHF and UHF signals and relayed by coaxial cable to a 100 channel selector box on the subscriber's television set. Using this box, the subscriber may choose from the combined offering of local broadcast signals and satellite-delivered programming, the same as with a subscription to coaxial cable.[1]

Does wireless cable represent a new technological method of delivering satellite programming? This question must be answered both yes and no. Yes, in the sense that wireless cable constitutes a new commercial enterprise sanctioned by the FCC in 1983 that delivers multiple channels of satellite programming through state-of-the-art reception, scrambling and addressing equipment. No, in the sense that wireless cable delivers this satellite programming via the same microwave frequencies utilized for many years by educators through Instructional Fixed Television Services ("IFTS"); municipalities through Operation Fixed Service ("OFS"); and retail distributors through Multipoint Distribution Service ("MDS"). In other words, just as modern coaxial cable originated from the cruder technology of community antenna television ("CATV"), so too did wireless cable grow out of the tried and true system of delivering satellite programming through microwave frequencies.

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[1] Many broadcast stations have had difficulty in securing carriage on coaxial cable systems. Coaxial cable systems all over the country that suffer from limited channel capacity are dropping broadcast stations in favor of other services. Wireless cable systems have no incentive to engage in such conduct. Because we pick broadcast stations up directly at the rooftop, and do not use our scarce SHF channels for retransmissions, we have nothing to gain by not passing an available broadcast signal to our subscribers. Regardless of what ultimately happens to the FCC's must carry rules, therefore, wireless cable is a system of "will carry"; if the broadcaster provides a VHF or UHF signal to the rooftop, we will carry it through our cable to subscribers. In addition, unlike many coaxial cable systems, wireless cable systems will carry all VHF and UHF stations on their assigned channels.

Wireless cable traces its origins to the Multipoint Distribution Service ("MDS") that started in the early 1970's. MDS systems delivered satellite programming through a single channel in the SHF band. Although limited to a single channel, MDS systems managed to forge market niches in particular areas by delivering HBO or a similar movie service to supplement the available VHF and UHF broadcast signals.2/

By the late 1970's, however, numerous other satellite-delivered programming services began to gain public recognition, for the most part through their carriage on coaxial cable systems. With only a single channel to offer, MDS essentially lost its ability to compete with coaxial

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2/ Even in the 1970's, coaxial cable operators displayed their affinity for anticompetitive conduct. In papers submitted to the FCC by the largest wireless cable firm, The Microband Companies, Inc., it was demonstrated that several coaxial cable operators warehoused the single SHF channel available prior to 1983 in areas where they operated or hoped to operate. As a result, the developments of MDS systems was preempted in many markets.

cable. Besides financial problems, some MDS operators experienced difficulty protecting their signal from reception by non-subscribers.

In 1983, however, the FCC opened up new possibilities for the delivery of satellite programming through the SHF band.[3/] Recognizing that "there is no multichannel alternative to cable available now,"[4/] the FCC created the commercial possibility of wireless cable by reallocating for "multichannel MDS use"[5/] unutilized SHF channels that had been reserved for IFTS (educators) and OFS (municipalities and public safety and informational organizations). In addition, the FCC authorized multichannel MDS "to negotiate with existing cochannel and adjacent channel users of the IFTS channels to attempt to reach an accommodation whereby the needs of each can be satisfied."[6/] The result of these new FCC rules was to make available for multichannel MDS use up to 33 SHF channels in each major market.

Concurrent with the FCC's rulemaking were several technological advancements in the delivery of satellite programming through microwave frequencies, including an

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[3/] See In the matter of Amendment of Parts 2, 21, 74 and 94 of the Commission's Rules and Regulations in Regard to the Instruction Fixed Television Service, the Multipoint Distribution Service, and the Private Operation Fixed Microwave Service, 54 R.R. 2d (Pike & Fisher) 107 (1983), attached hereto as Exhibit A.

[4/] Id. at 123.

[5/] Id. at 130.

[6/] Id.

antenna and channel selector capable of combining UHF, VHF and SHF signals and the Zenith scrambling and addressing equipment. The result is the state-of-the-art commercial enterprise known as wireless cable.[7/]

With its unique advantages, today's wireless cable represents a viable non-cable competitor in the market for satellite-delivered programming. Indeed, in areas unwired for cable, wireless cable can provide consumers with rapid access to satellite-delivered programming by eliminating the expensive and time-consuming process of burying wires below the streets or stringing them from telephone poles. Alternatively, in cable wired areas, wireless cable can compete head-on with cable, thereby checking the cable rate increases that have gouged consumers since deregulation under the Cable Act of 1984.[8/] Typically, wireless cable operators deliver programming to subscribers at lower costs. The principle reason is that coaxial cable wiring expenses are high and cable must wire an entire street to deliver programming to any individual home on the street. In contrast, wireless cable's fixed costs are smaller, and the marginal cost of each new subscriber -- the cost of installing an antenna on a particular home -- is less than the pass-by costs incurred by cable.

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[7/] Most coaxial cable systems are limited to less than 36 channels, including those allocated to broadcast. A wireless cable operator can theoretically offer up to 33 SHF channels _in addition to_ those broadcast channels received by the rooftop antenna.

[8/] _See_ Exhibit O and discussion _infra_ at 14-15.

Another advantage besides lower costs is that wireless cable operators deliver a signal as good if not better than today's coaxial cable systems. Moreover, with its state-of-the-art Zenith scrambling and addressing system, wireless cable can provide better signal security than coaxial cable. Gone are the signal theft and financial problems associated with the MDS systems of the 1970's.

In sum then, wireless cable represents a state-of-the-art viable competitive alternative to coaxial cable. As the General Electric Company recently noted:

> [Wireless Cable's] performance can meet and even exceed cable in fundamental performance areas like received signal level, carrier-to-noise ratio and nonlinear distortion products. Also [wireless cable] . . . equipment can provide all of the bells and whistles of a cable system like addressability, scrambling and stereo broadcasts. Combining comparable features and improved performance can make [wireless cable] . . . a very competitive alternative.[9/]

## INABILITY OF THE WIRELESS CABLE INDUSTRY TO OBTAIN PREFERRED PROGRAMMING

In spite of wireless cable's competitive potential, it remains unclear what markets are best suited for the wireless cable delivery system. With its unique economics, wireless cable may thrive in either or both cable wired areas and/or unwired areas as well as urban areas and/or rural areas. The salient point is that the marketplace provides

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9/ "Wireless or Wired Cable Comparable Technologies?" by George Harter on behalf of The General Electric Company, attached hereto as Exhibit B.

the most efficient mechanism for sorting the merits of the various satellite programming delivery systems, assuming it is permitted to function freely. The anticompetitive practices by cable companies and programmers, however, have stymied the market sorting mechanism.

The problem is simple: The wireless cable industry has been foreclosed from vigorous competition with coaxial cable operators due to its inability to obtain adequate satellite programming.[10/] Many programmers either refuse to deal with wireless cable operators, or, alternatively, deal only at discriminatory prices, terms and conditions. This discrimination against a viable competitor of cable has coincided with an increased vertical integration of cable into programming.[11/] In fact, many of the programmers that refuse to deal with wireless cable at fair terms and prices are owned in whole or in part by the large MSOs.

To view this problem in concrete terms, let's look at the largest MSO, Tele-Communications, Inc. ("TCI"), and the two largest wireless cable operators, The Microband

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[10/] At present, more than eighty firms and individuals possess FCC permits to deliver programming through wireless cable. See List of Wireless Cable Permittees attached hereto as Exhibit C. Of these permittees, however, only a handful are currently operating in Cleveland, Detroit and New York, among other places. See List of Wireless Cable Operators, attached hereto as Exhibit D. Many other entrepreneurs are attempting to bring wireless cable to other markets, but require assurances of program availability at fair terms and prices to start their businesses.

[11/] See "The Trend Toward Vertical Integration by Cable Into Satellite Delivered Programming" attached hereto as Exhibit E.

Companies, Inc., which delivers programming in New York, NY, Detroit, MI and Washington, D.C., and Metroten Cablevision, Inc., which serves the Cleveland, OH area. With respect to the trend towards vertical integration, TCI has been a leader. TCI holds an equity stake in a number of major programmers, including WTBS, CNN, Headline News, Black Entertainment Television, Tempo TV, the Fashion Channel and American Movie Classics.12/ Several of the programmers controlled in whole or in part by TCI continue to refuse to deal with such wireless cable firms as Metroten and Microband.13/

The Fashion Channel, for example, a home shopping network with over 8.7 million subscribers and in which TCI has a 10.5% equity stake, adheres to a cable exclusive distribution policy.14/ Several other TCI owned and/or controlled programmers have avoided explicitly stating a retail policy, but nevertheless are distributed in most major markets de facto exclusively through coaxial cable. These programmers include American Movie Classics, CNN15/ and Black

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12/ Id.

13/ See "The Programming Bottleneck," attached hereto as Exhibit F.

14/ See Letter from Fashion Channel to Metroten (Nov. 19, 1987), attached hereto as Exhibit G.

15/ Metroten distributes CNN, the second most popular basic service next to ESPN in the Cleveland, OH area. Metroten, however, pays a higher price for CNN than coaxial cable operators. Microband has been denied access to CNN in the New York and Detroit markets, but is authorized to distribute the service in Washington, D.C. See Exhibit F.

Entertainment Television.16/

Moreover, with its recent acquisition of Tempo TV, TCI now owns 10.1% of Turner Broadcasting System. Besides the fact that it already has 12.5 million subscribers, it is widely anticipated that "Tempo TV could serve another purpose: a launch platform for Turner Network Television."17/ TCI is interested in starting a new network-quality satellite-delivered channel, as is Turner Broadcasting System.18/ TCI and Turner could build such a channel by starting from the existing Tempo TV subscriber base. While Tempo TV has previously been available to wireless cable, Turner has explicitly proposed making TNT a cable-exclusive service.19/ If TCI denied wireless cable access to TNT, the anticompetitive effect would be even greater than a denial of access to the existing Tempo TV.20/

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16/ Microband is authorized to distribute Black Entertainment Network in Detroit and New York, but not in Washington, D.C. Microband has been refused Black Entertainment Television for the Washington market. Not surprisingly, the company awarded the Washington, D.C. coaxial cable franchise holds an equity stake in Black Entertainment Television.

17/ A Dynamite Tempo for TCI, Cable TV Programming, at 4 (Nov. 30, 1987); see Tempo Deal Expands TCI Reach, Cablevision at 12 (Nov. 23, 1987). Both articles are attached hereto as Exhibit H.

18/ The King of Cable TV, Business Week, at 88, 96 (Oct. 26, 1987), attached hereto as Exhibit I.

19/ Turner's TNT Adds Sparks to Atlantic Cable Show, Broadcasting, at 31 (Oct. 12, 1987), attached hereto as Exhibit J.

20/ Recognizing the anticompetitive potential of TCI's Tempo TV acquisition, the WCA has filed comments with the FCC that seek assurances of program availability.

Although a leader in the trend toward vertical integration, TCI is by no means alone. Viacom, for example, holds an equity stake in many major programmers, including MTV (100%); Lifetime (33%); VH-1 (100%); Cable Value Network (over 4%); and the Fashion Channel (over 4%).[21/] Other large MSOs hold similar equity stakes. Moreover, the programmers themselves have been cooperating with this vertical integration scheme by offering equity to coaxial cable operators. Such programmers include Cable Value Network, Teleshop, QVC Network, The Fashion Channel, The Travel Channel and Shop TV.[22/] This vertical integration has greatly enhanced coaxial cable's ability to cause denials of programming to wireless cable operators. In rare instances, wireless cable operators are permitted to distribute the service, but refused an equity stake.[23/]

The foreclosure of programming sources to wireless cable firms extends beyond programmers in which coaxial cable holds an equity stake. Many non-cable owned programmers also refuse to distribute through wireless cable systems. These programmers include USA Network, The Weather Channel, and The Disney Channel. Moreover, even when non-cable owned

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See Wireless Cable Association Comments on the Application for Transfer of Control of Tempo Enterprises' FCC Licenses (Mar. 4, 1988), attached hereto as Exhibit K.

[21/] See Exhibit E.

[22/] Id.

[23/] See Exhibit F.

programmers deal with wireless cable, they impose discriminatory terms and prices. ESPN, for example, the most popular programming service in the basic package, imposes discriminatory terms and prices on both Microband and Metroten.[24/]

In addition to vertical integration, the coaxial cable industry has become far more horizontally concentrated subsequent to deregulation. The MSOs have extended their local monopoly to a national level. Not surprisingly, conversations between WCA representatives and several non-cable owned programmers have revealed a fear of alienating these large MSOs. Of course, programmers are not likely to acknowledge publicly that coaxial cable operators influence or control their retail distribution policy with respect to wireless cable.

Even where cable franchises do not demand exclusive arrangements, many programmers are refusing to deal with wireless cable. The programmers' stated reasons include the view that wireless cable firms are not well-run; the claim that the wireless cable technology delivers a poor signal and is subject to theft; and the contention that future market penetration of such programming should be entrusted to cable. As discussed above, however, none of these reasons has a sound factual basis. Wireless cable firms are not merely expanded versions of the MDS single channel system of the 1970's. Rather, wireless cable firms represent totally new

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[24/] Id.

commercial enterprises sanctioned by the FCC in 1983 that deliver satellite programming through state of the art reception, scrambling and addressing equipment.

Moreover, recent actions by programmers reflect the spuriousness of any criticism of the technology of wireless cable. The marketplace is an efficient mechanism for sorting the merits of various technologies, assuming it is permitted to function freely. The fact is that programmers and coaxial cable operators have also aimed their efforts towards preventing the development of "overbuilds" for cable, *i.e.*, "second franchises" that use the cable technology.[25/] This demonstrates that established cable franchises oppose not only alternate delivery technologies (regardless of their engineering merits) but *any* competitive retailer of satellite programming. Recognizing that "efforts to promote one method or kind of retail distribution over another . . . can frustrate competition and ultimately harm consumers," Senator John Kerry has recently directed pointed questions to HBO and others regarding the anticompetitive aspects of wireline exclusivity. So far, however, he has received evasive and self-serving responses.[26/]

Whether the exclusive dealing arrangement is explicit or implicit, the salient point is that cable operators are obtaining exclusivity in absence of a

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[25/] Articles discussing wireline exclusivity proposals by various programmers are attached hereto as Exhibit L.

[26/] These letters between Senator Kerry and various programmers are attached hereto as Exhibit M.

competitive bidding process and for little or no cost. This suggests that an anticompetitive purpose or effect underlies the exclusive dealing arrangements between cable operators and programmers.

Of course, coaxial cable operators and programmers assert that these practices do not harm wireless cable as a competitor. They claim that wireless cable operators do not need a particular programming service to compete with coaxial cable operators. They argue, for example, that wireless cable operators do not need HBO when Showtime is available. Some coaxial cable operators and programmers even assert that wireless cable firms should develop their own programming services. Unfortunately, these arguments miss the point because subscribers buy programming not technology.

No single programming service can probably be considered "necessary" or "essential." Instead, the basic package should be viewed as a distinct product consisting of a selection of programming that includes news, shopping, sports, variety and access to movies and other premium programming. Without programming in all of these selection categories, a wireless cable operator cannot compete.

Another way of stating this notion is that each programming component of the basic package represents an incremental market share. The consumer makes a decision to subscribe based upon in essence not more than five or six components of the basic package, *i.e.*, the consumer "prefers" a package of particular components above all others.

Although when viewed in isolation, no single programming service is absolutely "necessary" or "essential," nevertheless when viewed as one component of the basic package, the absence of any one service, for example the absence of ESPN, the premier sports channel with exclusive rights to ten NFL games, may result in a loss of market power because the consumer will subscribe to the basic package that contains all six "preferred" components as opposed to the package with only three or four. In other words, an incomplete "basic" package cannot compete effectively with a complete package.

## THE HARM TO CONSUMERS RESULTING FROM ANTICOMPETITIVE PRACTICES BY COAXIAL CABLE OPERATORS AND PROGRAMMERS

Exclusive dealing, discriminatory dealing and vertical integration all have the effect of restraining competition at the retail level between coaxial cable and wireless cable operators. The biggest losers are the consumers. Indeed, consumers in areas unwired for cable cannot receive preferred satellite-delivered programming, while consumers in wired areas must pay monopoly prices for the delivery of such programming via coaxial cable.[27/]

Subsequent to deregulation under the Cable Act of

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[27/] See J. Ordover & Y. Braunstein, "Does Cable Television Really Face Effective Competition?" (Dec. 1987) (proving that coaxial cable operators do not face effective competition from three broadcast stations) Shoshan & Jackson, Inc., "Opening the Broadband Gateway" (Jan. 20, 1988) (proving that coaxial cable operators earn monopoly profits). Both papers are attached hereto as Exhibit N.

1984, coaxial cable subscription rates have increased an average of 27 percent, according to a National League of Cities survey, and 24 percent, according to a study by Paul Kagan Associates. Moreover, prices in many areas have risen over 50 percent since deregulation.[28/]

Concurrent with these price increases has been the practice of retiering by many coaxial cable operators. In essence, retiering may force consumers to pay for programming that they do not want. In West Virginia, for example, American Cable Television, Inc. ("ACT") combined its basic and satellite tiers and doubled its prices.

Anticonsumer actions by coaxial cable operators have outraged many state and local communities. As a result of ACT's post-deregulation behavior, the Attorney General of West Virginia has filed an antitrust and unfair trade practices action on behalf of consumers.[29/] Similarly, the residents of Springfield, Oregon, angered by retiering and rate increases of over 50 percent, have launched an initiative whereby the public utility would take over the

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[28/] These price surveys, as well as various articles reporting on this issue are attached hereto as Exhibit O.

[29/] The State of West Virginia through its Attorney General, Honorable Charles G. Brown, has filed a parens partrie action charging American Television and Communications Corp. with antitrust and consumer protection violations in connection with its post deregulation behavior. See Exhibit P attached hereto. In addition, the National Association of State Attorney Generals ("NAAG") has formed a multistate antitrust task force to investigate the anticompetitive practices of cable and programmers. See Exhibit Q attached hereto.

coaxial cable system now operated by TCI.[30/]

Exclusive dealing arrangements between coaxial cable operators and programmers, discriminatory dealing by programmers with viable cable competitors, vertical integration by cable into programming, outrageous coaxial cable subscriber rate increases and coercive coaxial cable subscriber terms and conditions all add up to only one thing: coaxial cable operators constitute an unrestrained monopoly in the market for satellite-delivered programming. Indeed, the largest MSO, TCI, has been found guilty of monopolizing at least one geographic market and currently faces charges of monopolizing several others.[31/] Moreover, other coaxial cable operators have been admitted to being monopolies, but argue that they represent a lawful monopoly.[32/] Yet, it seems incredible to suggest that with the passage of the Cable Act of 1984, Congress intended to usher in an era of coaxial cable monopolization. Indeed, coaxial cable operators contended before Congress that only through

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[30/] See Exhibit O.

[31/] See, e.g., Central Tele-Communications, Inc. v. TCI Cablevision Inc., 800 F.2d 711 (8th Cir. 1986), cert. denied 107 S. Ct. 1358 (1987); H.R.M., Inc. v. Tele-Communications, Inc., 653 F. Supp. 645 (D. Colo. 1987) Copies of these opinions are attached hereto as Exhibit R.

[32/] See Friedman v. Adams Russell Cable Services-New York, Inc., 624 F. Supp. 1195 (S.D.N.Y. 1986), attached hereto as Exhibit S; Memorandum in Support of Motion of American Television and Communications Corporation to Dismiss the Complaint, State of West Virginia v. American Tel. & Comms. Corp., No. 0203 (S.D.W.V. dated Dec. 18, 1987). See Exhibit Q.

deregulation under the Cable Act of 1984 could they compete with other satellite programming delivery systems such as wireless cable.

## THE SOLUTION TO THE COAXIAL CABLE MONOPOLY PROBLEM

For the benefit of consumers, legislative action must be taken to curb the anticompetitive practices of coaxial cable operators and programmers that threaten to destroy wireless cable and other viable competitors in the retail distribution market for satellite programming.[33/] At the very least, coaxial cable operators should be required to compete with wireless cable operators on the basis of service and price. In other words, the consumer should decide the relative merits of each delivery system, rather than be forced to accept or reject the product offered by the local coaxial cable monopolies.

Effective head-to-head competition will not become a reality, however, until wireless cable operators obtain access to preferred satellite-delivered programming. By "access," I mean an opportunity to obtain such programming for retail distribution at nondiscriminatory terms and

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[33/] The WCA applauds the NAAG investigation into coaxial cable operators' anticompetitive practices. It also supports lawsuits at the state level on behalf of consumers, such as the West Virginia action. The scope of the coaxial cable monopoly and its long-term threat on a nationwide level, however, suggest that legislation may provide the most far-reaching and effective solution. Indeed, legislation seems particularly appropriate given that Congress did not intend to create an unrestrained cable monopoly with the passage of the Cable Act of 1984.

prices. Any exclusive distribution rights must result from a competitive bidding process. Such vigorous competition will most benefit the consumers, who have been either denied access to preferred programming or forced to pay monopoly rents. Coaxial cable competitors like wireless cable will also reap the rewards of a free marketplace. Moreover, programmers should support vigorous competition as well, for elementary economic principles suggest that no manufacturer or wholesaler desires a monopoly at the retail distribution level. In such a state of vigorous competition, the only losers are the coaxial cable monopolists. They will lose the business weapons of exclusivity, discrimination, vertical integration and monopoly rents. Coaxial cable operators will be forced to deal fairly with consumers, to cease leveraging and coercing programmers and to compete vigorously with wireless cable operators. With this state of affairs, everyone wins. Most of all the consumer is benefitted.

Thank you.

EXHIBIT A

INSTRUCTIONAL TELEVISION FIXED SERVICE (MDS REALLOCATION)

FCC 82-243
33344
48 FR

| | |
|---|---|
| In the Matter of | |
| Amendment of Parts 2, 21, 74 and 94 of the Commission's Rules and Regulations in regard to frequency allocation to the Instructional Television Fixed Service, the Multipoint Distribution Service, and the Private Operational Fixed Microwave Service | General Docket No. 80-112 |
| Inquiry into the development of regulatory policy with regard to future service offerings and expected growth in the Multipoint Distribution Service and Private Operational Fixed Microwave Service, and into the development of provisions of the Commission's Rules and Regulations in regard to the compatibility of the operation of satellite services with other services authorized to operate in the 2500-2690 MHz band | |
| Amendment of Part 21 of the Commission's Rules to Permit the Use of Alternative Procedures in Choosing Applicants for Radio Authorizations in the Multipoint Distribution Service | CC Docket No. 80-116 |
| Petition for Rule Making filed by Microband Corporation of America to amend Section 21.901 of the Commission's Rules and Regulations | RM-3540 |
| Application of Channel View Inc. for an Experimental (Developmental) station at Salt Lake City | File No. 8938-ED-MR-82 |
| Application of Contemporary Communications Corporation for Developmental Authorizations to Establish Multi-Channel Systems (MCS) in New York, Chicago, Los Angeles, St. Louis and Philadelphia | File No. BPEX-820802KH |

Adopted: May 26, 1983
Released: July 15, 1983

[¶54:902, ¶54:931, ¶71:901, ¶71:909] ITFS-MDS reallocation.

In view of the likelihood that demand for ITFS channels for use by institutions of higher learning (for the delivery of graduate level training to the workplaces of engineers, scientists and other professionals), while increasing, will not match the demand for multichannel MDS facilities if such facilities are authorized, the Commission amends the rules to reduce the restrictions on multichannel MDS systems and reallocates eight channels from the ITFS to the MDS. While the Commission believes that it remains in the public interest to have a spectrum reserve for the ITFS, moreover, there * * *

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Appendix A List of Commenters
Appendix B Amended Rules
Appendix C Amended Forms

## I. Introduction and Summary

1. On May 2, 1980 the Commission released a Notice of Inquiry and Proposed Rule Making and Order in General Docket 80-112, 45 FR 29,323 (1980) (hereinafter Notice), in which it proposed to reallocate the 2500-2690 MHz band to provide additional channels for the Multipoint Distribution Service (MDS) and the Private Operational Fixed Microwave Service (OFS) and to reduce the number of channels available for the Instructional Television Fixed Service (ITFS). The Notice referred to these services as "area wide microwave distribution services" (AMDS) and inquired into their future prospects and anticipated growth.

2. Approximately 200 entities submitted comments and reply comments in response to the Notice. On February 10, 1982 Microband Corporation of America (Microband) submitted a 3 volume proposal to create what it termed a "wireless cable system" using frequencies in the 2500-2690 MHz band. Proposal of Microband Corporation of America, General Dockets 80-112 and 80-113 (February 10, 1982) (hereinafter Microband Proposal). Microband simultaneously submitted a "Motion for Acceptance of Additional Comments" requesting that its proposal be accepted as additional comments in this proceeding and in the companion proceeding in General Docket 80-113. 1/ On April 20, 1982 the Chief of the Common Carrier Bureau, acting pursuant to delegated authority, issued an order accepting the Microband Proposal as additional comments in these dockets and inviting interested parties to submit reply comments. Order Accepting Additional Comments, 47 FR 18,932 (1982). Approximately 190 reply comments were received in response to the Microband proposal. 2/

3. On August 2, 1982 Contemporary Communications Corporation (CCC) submitted a set of applications in which it requested developmental authority to construct what it termed Multi-Channel Systems (MCS) in New York, Philadelphia, Chicago, St. Louis and Los Angeles. The CCC applications are similar in some respects to the Microband proposal and to the experimental authorization we granted to Channel View in Salt Lake City (see Note 24, infra). They are different in that Microband filed additional comments in response to the Notice while Channel View requested authority to construct experimental facilities in Salt Lake City. CCC specifically requested authority to conduct market trials in five cities. It made two basic claims in support of * * *

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1/ Notice of Inquiry and Proposed Rule Making in Gen. Docket No. 80-113, FCC 80-137, 45 FR 29,350 (April, 1980). In that proceeding the Commission proposed to revise certain technical rules applicable to the Multipoint Distribution Service, operating in the 2150-2162 MHz band, and inquired into the feasibility of applying the proposed rules to 2500-2690 MHz band.

2/ A list of all those submitting comments in this proceeding is contained in Appendix A. This list includes all comments both formal and informal. Comments that were not filed in a timely manner are hereby accepted as informal comments. Some entities submitted more than one set of comments and hence are listed more than once.

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B. The 2500-2690 MHz Band

7. This band is divided into thirty-one 6 MHz channels and thirty-two 125 KHz response channels. Twenty-eight of the 6 MHz channels and the same number of response channels are allocated to the ITFS. 47 CFR §§74.902, 74.939. The remaining three 6 MHz channels and three response channels are allocated to the OFS. 47 CFR §94.65(f). The remaining 125 kHz reponse channel is not assigned to either service.

C. ITFS

8. The ITFS was created by a Report and Order in Docket No. 14744 adopted by the Commission in 1963. Educational Television, 39 FCC 846 [25 RR 1785] (1963), recon. denied, 39 FCC 873 [2 RR 2d 1615] (1964) (hereinafter ETV). By this action the Commission allowed the newly created ITFS to use the 2500-2690 band on a shared basis with the existing OFS stations with the proviso that no new OFS stations be authorized in the band for 3 years except for modifications or expansions of existing stations, or for the use of the band by OFS eligible entities for television transmission in accord with ITFS technical standards. Prior to this action the band had been allocated to the Fixed Service for shared use by Operational Fixed Stations and International Control Stations. In taking this action, the Commission stated its intention to observe the amount of use of these channels by educators and "[to] determine what course of action should be taken to encourage the fullest development of the 2500-2690 Mc/s band . . . " at the end of the three year period. Id. at 851.

9. The Commission stated in 1963 that the purpose of the service was to transmit:

> "instructional material to selected receiving locations in accredited public and private schools, colleges and universities for the formal education of students. Systems which have been licensed for this purpose may also be used for other incidental purposes among which are the transmission of cultural material and entertainment to these same receiving locations; the transmission of special training material to selected receiving locations outside the school system such as hospitals, nursing homes, training centers, clinics, rehabilitation centers, commercial and industrial establishments, etc.; the transmission of special material to professional groups or individuals to inform them of new developments and techniques in their fields and instruct them in their use; and to perform other related services directly concerned with formal or informal instruction and training. When not beng used for such purposes, the facilities licensed under these rules may be used for handling administrative traffic of the licensee such as the transmission of reports and assignments, conferences with personnel, etc. Individual stations or complete systems will not be licensed solely for handling administrative traffic."

ETV, 39 FCC at 853. The Commission further stated that this service could also be used for the relay of such material. Id. These service limitations are contained in §74.931 of the rules, 47 CFR §74.931. Elsewhere in this Order, we are amending §74.931 to allow ITFS licensees to lease any excess capacity available on their channels (paragraphs 110 - 127, infra). In addition, we are today opening another proceeding in which we propose, inter alia, to broaden permissible uses of the ITFS channels.

10. The Commission limited the eligibility to hold an ITFS license to accredited institutions providing a program of formal education and to those eligible to hold a non-commercial educational TV license. ETV, 39 FCC at 853-854. The eligibility standards for the ITFS are contained in §74.932 of the rules, 47 CFR §74.932.

11. The Commission did not consider the use of this band again until 1971 when it adopted the Second Report and Order in Docket No. 14744. Instructional Television, 30 FCC 2d 197 [22 RR 2d 1635] (1971) (hereinafter ITV). In that proceeding the Commission made the present exclusive allocation of 28 channels to the ITFS.

D. OFS

12. As noted above, prior to 1963 the 2500-2690 MHz band was allocated to what was then known as the Fixed Service. When the Commission established the ITFS it allowed the newly created

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service to use this band and limited the Fixed Service [illegible] the band for three years to expansion or modification of existing stations, or the establishment of new television transmission stations. The traditional Fixed Service use of this band was not for television transmission but rather was for more traditional private microwave communications uses such as multichannel voice and data circuits. The Commission recognized that there were certain traditional OFS users such as municipalities that might have television transmission needs and, although it declined to allow such entities to apply as ITFS applicants, it did invite them to apply for facilities under the rules governing the public safety radio services. ETV, 39 FCC at 854. When the Second Report and Order was adopted in Docket No. 14744 the Commission determined that the video transmission needs of municipalities and other entities eligible for Fixed Service licenses could be met by a 3 channel allocation. It based this conclusion on the fact that only 16 stations had been licensed to such entities. ETV, 39 FCC at 200. The Commission further suballocated these channels to the Public Safety Service on a primary basis and to all other fixed service eligibles on a secondary basis. 4/ This preference was deleted in 1975 when the Commission created what is now known as the Private Operational Fixed Microwave Service. Private Operational Fixed Microwave Service, 52 FCC 2d 894, 900 [33 RR 2d 1047] (1975). That action made the three channels available to all eligible entities on an equal basis.

13. In 1973 the Commission authorized Columbia Pictures to use what was then known as Business Radio Service spectrum for the distribution of "feature motion picture films" and associated promotional material to "guests" in "hotels." Columbia Pictures Industries, Inc., 39 FCC 2d 411, 413 [26 RR 2d 711] (1973). In making this grant, the Commission questioned whether this was an appropriate use of the Business Radio Service spectrum and as a result specifically conditioned the grant on the result of the inquiry and rule making proceeding in General Docket 19671 5/ that was initiated simultaneously with the grant. Id. at 412, n. 1.

14. In 1981 the Commission issued the First Report and Order in Docket No. 19671. Use of Private Microwave Frequencies, 86 FCC 2d 299 [49 RR 2d 931] (1981), stay denied sub nom. Operational Fixed Microwave Services, 87 FCC 2d 768 (1981). After considering the comments submitted in response to its inquiry, the Commisson concluded "that it is in the public interest to allow the use of the OFS frequencies for distribution purposes and, more generally, to restrict as little as possible alternative uses of the spectrum." Id. at 306. In allowing this use of the OFS spectrum, the Commission noted that it was only "authorizing a licensee to distribute products and services in which the licensee has an ownership or other interest to the licensee's own customers or subscribers." Id. at 309. The Commission also specifically declined to authorize a licensee of "point-to-multipoint" microwave facilities in the OFS to transmit any video programming directly to apartment houses, MATV systems or private homes pending resolution of the question of whether the similarity of such services to services such as subscription television requires that they be similarly regulated. Id. at 311.

15. In the Notice the Commisson concluded that if it were to authorize the use of the OFS to distribute entertainment programming to subscribers there would be an increase in demand for the OFS channels in the 2500-2690 MHz band. Notice, supra at para 37. Since the adoption of the First Report and Order in Docket 19671, we have received more than 1,400 applications from 60 different entities seeking to provide video entertainment services on the 3 OFS channels. In a separate action, we are today excluding the distribution of video entertainment material on OFS frequencies lower than 21.2 GHz for two years. 6/ 47 CFR §§94.9(a)(1), 94.9(b)(2)(iii).

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4/ When the Commission allowed the newly created ITFS to use the 2500-2690 MHz band, the move was resisted by the traditional users of this band on the basis that what was being created was a "quasi-broadcast" service and that other portions of the spectrum were more suitable for the new service. It was further argued that the decision could result in the permanent exclusion of operational fixed users from the band. ETV, supra, at 874.

5/ Transmitting Program Material to Hotels, 39 FCC 2d 527 (1973).

6/ Memorandum Opinion and Order , Docket No. 19671, FCC 83-245, released June 23, 1983.

16. Because we have decided not to allow the distribution of video entertainment material on the OFS channels in the 2500-2690 MHz band at this time, we have concluded that there is no reason to provide additional spectrum for that service in this band. Thus, we will not consider OFS further in this order.

## III. Discussion

### A. Spectrum Utilization

17. The Commission based its proposals to reallocate the 2500-2690 MHz band on three tentative conclusions. First, it concluded that the demand for MDS service exceeded the supply. This conclusion was based primarily on the observation that there were a large number of situations in which more than one party had filed for the same channel and that many applicants were proposing to "short space" stations. Notice, at paras. 19-23. Second, it was concluded that the 2500-2690 MHz band was under-utilized. Id. at para. 28. Finally, it was concluded that if the existing restrictions on the use of the OFS channels were removed there would be increased demand for these channels. Id. at para. 57. The Commission recognized a need to develop a better record concerning the facts on which these tentative conclusions were based. For this reason a series of questions was included in the Notice to elicit the kind of information needed to make a reasoned decision on the issues before the Commission. Id. at para. 52 and Appendix C.

#### 1. ITFS Spectrum Use

18. Very few of the comments filed in this proceeding contained quantitative information concerning the use of the ITFS spectrum. Most of the comments filed by the ITFS community expressed the view that the spectrum should not be reallocated and supported this proposition with public policy arguments rather than spectrum utilization data. The policy arguments raised in these comments are discussed below. See paras. 52-64 infra.

19. The most extensive analysis of current ITFS spectrum use was submitted by the Center for Excellence (Centex) of Williamsburg, Virginia. [7] The Centex data showed that as of August 1980 there were 82 operating ITFS stations using 492 channels. The 82 systems were spread over 27 states. California had 15 operating systems and New York had 11 operating systems. Of the 27 states that had operating systems 13 had only one system operating. The Centex analysis also contained data on ITFS channels use in the top 50 markets as defined by the 1979 Arbitron population book. These data showed that in only one market, Los Angeles, were all the ITFS channels being used. In fact, the data showed that the Los Angeles market had 40 channels in use with applications pending for 8 more channels. The data also showed heavy use in several other markets. New York, Chicago, San Francisco, Boston, Cleveland, Dallas, Ft. Worth, San Diego, and Milwaukee all had 10 or more channels in use. On the other hand Pittsburgh, St. Louis, Seattle, Baltimore, Hartford, and many other large cities had no current channel use. The total number of channels being used in the top 50 Arbitron market was 319. Of these, 232 were operating in the 9 cities listed above as having more than 10 channels operating. Comments of Center for Excellence, Inc., General Docket 80-112, Attachment C (September 26, 1980) (hereinafter Centex comments).

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[7] The Center for Excellence, Inc. (Centex) "is a non-profit Virginia Corporation engaged in educational, medical and social services delivery, research and research development." Comments of Center for Excellence, Inc. General Docket No. 80-112, at 1 (September 26, 1980). In 1976 Centex began a study program that included a "biennial study of the use of ITFS across the Nation." This study was updated in 1980. Id. Attachment C, 7-8. This data was referred to by several commenters from the ITFS community and many included portions of it with their comments.

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20. Microband included as part of its proposal an "ITFS Spectrum Utilization Study." In making this study, Microband claimed that it had been unable to find a "single authoritative source or data base identifying the location and ownership of all ITFS channel licenses." Microband Proposal, supra, Appendix H, 1. Microband produced its analysis on the basis of data from: "(a) the FCC non-Government Frequency List, (b) TV Fact Book, (c) Compucon and (d) copies of licenses obtained through Downtown Copy Center." Id. 8/ 9/

21. The Microband survey was different from the Centex survey in several respects. The Centex survey was a compilation of existing and proposed licensees by channel group on a city-by-city and a state-by-state basis. The Microband survey listed on a city-by-city basis for each channel whether there was an existing licensee either within 25 or 50 miles of the coordinates of the Channel 1 MDS station. 10/ This methodology could have resulted in Microband showing a channel in use where Centex showed it vacant or vice-versa. It is more likely, however, that Microband would show a channel as being occupied that Centex showed to be vacant because the Microband data was based on a 50 mile spacing and was on a channel-by-channel basis as opposed to the channel group basis used by Centex. Thus, the Microband data represents a finer grain analysis of channel use than the Centex study. On the basis of its study, Microband concluded that within 25 miles of the location of the MDS Channel 1 station 75% of the ITFS channels are not licensed. It also showed that in 38 of the 50 markets surveyed less than half the channels were licensed.

22. The Commisson staff conducted its own spectrum utilization studies based on all stations licensed as of November 1, 1982. 11/ The staff study showed that there were 124 licensed ITFS operators using 808 channels. These operators were distributed over 29 states and the District of Columbia. More than half of the licensed channels were located within 25 miles of a major metropolitan area. There were 21 states with no ITFS licensees, 9 states with 1 licensee and 5 states with 2 licensees. On the other hand, California had 22 licensees using 167 channels, New York had 13 licensees using 76 channels, Florida had 12 licensees using 22 channels and Pennsylvania had 8 licensees using 53 channels.

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8/ The Downtown Copy Center is a private organization that contracts with the Commission to reproduce our public records and sell the reproductions to the public.

9/ The 50 cities that Microband submitted data for were not the same cities that were the subject of the Centex survey. Centex surveyed the 50 Arbitron markets, whereas Microband surveyed the 50 cities listed in §21.901 of the rules, 47 CFR §21.901. The two surveys contain 40 common cities. The cities in the Microband survey that were not in the Centex survey were Akron, Anaheim, Gary, Rochester, San Antonio, San Bernardino, San Jose, Syracuse and Toledo. Ft. Worth was considered separately from Dallas in the Microband Survey. The two were consolidated in the Centex Survey. The Cities in the Centex survey that were not surveyed by Microband were Nashville, Charlotte, Greenville, Grand Rapids, Orlando/Daytona Beach, Charleston, Raleigh, Harrisburg, Salt Lake, and Wilkes Barre.

10/ Microband conducted its surveys at 25 and 50 miles because it is generally assumed that if cochannel MDS stations are located more than 50 miles apart, there is unlikely to be harmful cochannel interference. It is also assumed that if cochannel stations are closer than 25 miles that harmful interference will occur. When the separation is between 25 and 50 miles, a detailed interference study must be done to assess the possibility that harmful cochannel interference will occur. Thus, if there are cochannel stations within 25 miles of a proposed transmitter location, the channel is deemed to be in use and not available. If there is no cochannel station within 50 miles of the proposed transmitter location, the channel is likely to be available.

11/ This survey was done using the Commission's ITFS station card file that is readily available to the public. This file includes all licensed ITFS stations and all stations for which a construction permit has been issued. It is possible that some of the stations included are no longer operating and it is also possible that some stations had not been indexed; however, we believe that it represents a generally accurate picture of ITFS channels use. This study has been made a part of the record in this proceeding.

23. The Commission staff also did a computer analysis of the ITFS channel use in the same markets Microband used in its study. The staff analysis was only done for 25 miles. That is, the analysis only considered those ITFS stations located within 25 miles of the MDS station coordinates. The results of the staff analysis were not identical to the results submitted by Microband; however, they were similar. The staff analysis showed more ITFS stations than the Microband study because the staff study was done later and hence included more recently licensed ITFS stations. It should also be noted that the staff analysis also included stations for which construction permits had been granted but which had not yet been licensed. Neither study included pending applications.

24. In its comments on the Microband proposal, the Corporation for Public Broadcasting (CPB) pointed out that the issue of adjacent channel operation must be considered before any conclusions can be drawn concerning spectrum use or availability. The 2500-2690 MHz spectrum is divided in 7 groups of four 6 MHz channels and 1 group of three 6 MHz channels. The channels within each group are not adjacent; they are alternated with those of another group to provide a 6 MHz guard band between the channels within each group. Traditionally ITFS licensees have been granted up to 4 channels in a single group. The operation on these channels is protected from adjacent channel interference where feasible by not licensing the guard band channel in the same area. This means that if the A group channels (A1, A2, A3, A4) were licensed in a given area, the B group channels that serve as the guard band channels for the A group channels (B1, B2, B3, B4) would not be licensed in the same area. For these reasons, CPB suggests that in analyzing channel use the adjacent channels should also be considered occupied. 12/ CPB redid the analysis submitted by Microband on the basis that if a cochannel were licensed within 50 miles of a given set of coordinates or an adjacent channel were licensed within 25 miles of the same coordinates, the channel was in use in that area. CPB also included all channels applied for as well as those licensed in its analysis. The CPB analysis indicates much greater channel use in the 50 metropolitan areas than either the Microband survey or the Commission staff analysis. The CPB analysis does, however, indicate that in 24 of the 50 cities surveyed there are 8 or more adjacent channels available. Further Comments of the Corporation for Public Broadcasting, Engineering Statement, 8, 9 and Figure 11 (July 2, 1982).

25. Although the studies submitted and the study made by the Commission's staff did not produce identical results, the results are similar enough to allow certain conclusions to be drawn. First, in several large metropolitan areas the ITFS channels are heavily licensed. On the other hand, there are several large metropolitan areas in which there are no licensed ITFS stations. Finally, there is little ITFS spectrum in use outside the large metropolitan areas. We believe these conclusions tend to confirm the tentative findings made in the Notice that while the ITFS channels are heavily licensed in some metropolitan areas, they are not heavily licensed in other metropolitan areas. Further, neither CPB nor any other commenter offered any evidence that the ITFS channels are heavily licensed outside the major metropolitan areas.

### 2. MDS Spectrum Use

26. As of December 22, 1982 there were 234 licensed MDS Channel 1 stations. These licensees were distributed over 50 states, the District of Columbia, Puerto Rico and the Virgin Islands. Construction permits had been granted for an additional 114 stations. There were 194 pending Channel 1 applications. Of these, 172 were mutually exclusive with at least 1 other application. There were 5 licensed Channel 2 stations. Construction permits had been granted for 3 additional stations. There were 143 pending applicaitons for channel 2 licenses in 42 cities. All of these applications were mutually exclusive with at least 1 other application. There were 3 licensed Channel 2A stations. Construction permits had been granted for 16 additional Channel 2A stations. In addition, there were 9 pending Channel 2A applications for 4 cities. Of these applications, 8 were mutually exclusive with at least one other application.

27. The Commisison does not keep records of whether licensed MDS stations are actually operating. Since MDS is a common carrier service, whether a station is on the air at a given time is not determined by the licensee but rather by whether a customer has purchased time from the licensee. At least one private concern, Paul Kagan Associates, Inc., collects such data.

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12/ We do not agree that use of one channel group necessarily precludes use of the interleaved channel group. See paras. 65-78, infra.

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According to its latest report, as of August 3, 1982, there were 82 MDS stations operating and an additional 120 stations licensed that had not yet obtained a customer. "Statistical Progress of MDS," The MDS Data Book, 64 (October 1982).

28. MDS Channel 1 licenses have been granted in 49 of the 50 markets listed in §21.901(c) of the rules, 47 CFR §21.901(c). A construction permit has been granted for the remaining city. Of the 49 stations licensed, 43 have customers. Outside of these markets there were, as of the date of the Kagan survey, 152 stations licensed. Of these 39 had customers. On the basis of these facts, it can be concluded that the MDS Channel 1 is heavily used in the larger metropolitan areas but less used outside these areas.

29. All the Channel 2 applications that are not mutually exclusive have been granted. As of December 12, 1982 five stations had been licensed and construction permits had been granted for three additional cities. Only one of these channels has a customer. As was pointed out in the Notice, there are certain technical problems that limit the simultaneous use of Channel 1 and Channel 2 in the same area. The nature of the downconversion equipment used in MDS is such that if different operators are using Channel 1 and Channel 2, the Channel 1 subscribers will be able to receive the Channel 2 programming and the Channel 2 subscribers will be able to receive the Channel 1 programming. Scrambling of both signals would negate this problem, but it is expensive to add scrambling to existing MDS systems. This means that if we were to authorize a Channel 2 station in an area that already has a Channel 1 station delivering unscrambled programming and the Channel 2 station offered scrambled service, the customers of the Channel 2 operator could receive both the scrambled Channel 2 programming and the unscrambled Channel 1 programming. There is a Channel 1 station authorized in every locale that has a Channel 2 available. Furthermore, because Channel 1 and Channel 2 have no guard band between them, it is possible that noncolocated Channel 1 and Channel 2 transmitters could cause unacceptable adjacent channel interference.

30. These factors have contributed to the light use of MDS Channel 2. In one city, Phoenix, Arizona, these problems have been overcome. There, Microband is the licensee of Channel 1 and Contemporary Communications Corporation is the licensee of Channel 2. American Cable Television is the subscriber of both Microband and Contemporary and programs both channels and has a common set of customers receiving two-channel service.

### 3. Projected ITFS Growth

31. One of the most controversial issues raised in this proceeding concerns the projected ITFS growth. In the Notice, the Commission concluded that there are no reasons to expect some growth in the demand for ITFS channels, but not such a significant amount that most vacant channels could be expected to be lifted. Several commenters from the ITFS community took issue with these conclusions. The comments submitted by the University of Maryland were typical. It claimed that the Commission's conclusion was a "vast underestimation of future ITFS demand." Comments of the University of Maryland, General Docket 80-112, at 3, (September 26, 1980). Those commenting on this issue gave several reasons why they believed the future demand for ITFS channels was much greater than the Commission envisioned.

32. The most commonly made argument concerned availability of funding. Many commenters pointed out that ITFS growth took place without any federal funding until the Public Telecommunications Financing Act of 1978, 92 Stat 2405 (1978) (47 USC §§390-399), authorized The National Telecommunications and Information Administration (NTIA) to make funds available for ITFS facilities. The NTIA has informed us that in 1979 $1,130,000 was made available for 4 ITFS systems. In 1980 $211,937 was made available for 3 systems; in 1981 $815,260 was made available for 4 systems and in 1982 $570,435 was made available for 4 systems. Thus, NTIA records show that since ITFS has become eligible to receive such funds 15 ITFS systems have received a total of $2,727,682. 13/

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13/ This information was furnished by the Policy Branch of the Office of Policy Coordination and Management of the National Telecommunications and Information Agency.

33. Other commenters have stressed that the increased use of ITFS to deliver graduate level engineering, scientific and business training directly into the work places of those needing such training will result in accelerated demand for ITFS channels. Typical of the systems referred to are those operated by Stanford University and the Illinois Institute of Technology. Stanford operates a 4 channel ITFS system known as the Stanford Instructional Television Network that is used to transmit graduate level engineering courses and continuing education courses to approximately 20 high technology companies located in California's "Silicon Valley." In its comments, Stanford indicated that it will likely need more channels in the future to satisfy the increased demand for this type of educational service. Comments of the Leland Stanford Junior University, General Docket 80-112, Attachment B (September 26, 1980).

34. The Illinois Institute of Technology (IIT) operates a 4 channel ITFS system known as Interactive Instructional Television (IIT/V) that is used to provide graduate level engineering education to over "1200 professional engineers, scientists, and managers annually in the greater Chicago area." Comments of the Illinois Institute of Technology relative to Microband Proposal, Docket 80-112 and 80-113, at 2 (July 2, 1982). In its comments, IIT presented data that indicated the level of enrollment in its program has risen constantly from approximately 100 students per semester in 1976 to approximately 550 students per semester in 1980. (Comments of Illinois Institute of Technology, Docket 80-112, at 8 (September 26, 1980)).

35. In some states graduate level and other post secondary instructional television is handled on a state-wide basis by a single entity. For example in Indiana, the Indiana General Assembly established the Indiana Higher Education Telecommunications Systems (IHETS) to provide for the development of telecommunications systems to meet the needs of public and private post secondary institutions in Indiana. IHETS operates 23 ITFS stations in sixteen Indiana cities using 28 ITFS channels. 14/ IHETS intends to add three additional channels to this system in the near future. In the longer term, IHETS sees the need for 19 more channels in Indiana. These stations are used to distribute medical, engineering, and other forms of post secondary education throughout the state of Indiana. Comments in Opposition to Microband Proposal, General Dockets 80-112 and 80-113, James R. Potter, Indiana Higher Education Telecommunications System (July 8, 1982). The IHETS plan is typical of State wide plans to use the ITFS channels. Other states have similar systems either operating or planned.

36. Less comment was received on the future growth in the use of the ITFS channels by elementary schools, junior high schools, and high schools. Dr. Gerald A. Rosander, County Superintendent of Schools, Department of Education, San Diego County, submitted extensive comments showing that virtually all the ITFS channels are used in San Diego. Much of this use is for primary, junior high, and high school education. Comments were received from most of the school districts in San Diego County articulating the value of ITFS delivered programming at these educational levels. Comments expressing the same view were also submitted by several teachers from San Diego County Schools. Thus, while very little comment was received on the projected growth in the use of ITFS for the delivery of educational programming at this level it is possible that if other school systems followed the lead of San Diego County there would be increased demand for ITFS channels by such secondary school systems.

37. Some comments suggested, on the other hand, that the future growth of ITFS may be limited at this time by what was referred to in the comments submitted by the National Education Association and others as "the proposition 13 mentality." Comments of the National Education Association, Docket 80-113, Appendix A, at 2 (September 30, 1980). These commenters note that when the amount of money available for public schools is being reduced by taxpayers, expenses for educational technologies such as ITFS are usually among the first to be reduced or eliminated. NEA also pointed out that there is a general reluctance on the part of educators to use new technologies. It stated that "many teachers and administrators tend to view educational innovations as fads that will pass if they are ignored." Id.

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14/ It is useful to note that IHETS provides these 28 channels of service using only 12 different ITFS channels. Furthermore, it does not use more than 4 channels in any city. It uses 4 channels in one city, 3 channels in another city, 2 channels in six cities, and 1 channel in nine cities. Of the 12 channels used, Channel $A_1$, $B_1$, and $D_1$ are used 4 times, Channels $A_2$ and $G_2$ are used 3 times, Channels $C_1$, $D_2$, and $E_1$ are used twice and Channels $B_2$, $E_2$, $F_1$ and $F_2$ are used once.

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38. Another commenter, the United States Catholic Conference (USCC), indicated that when the Catholic Church institutes its nationwide satellite network, to be known as the Catholic Telecommunication Network of America, local dioceses will use ITFS facilities to connect the satellite earth stations with the end user of the communication service. It is estimated that at least 700 and perhaps as many as 1,050 ITFS channels may be required to fill this need. Comments of Department of Communications, United States Catholic Conference, General Dockets 80-112 and 80-113, 3 (July 2, 1982). The services to be offered on these channels are described as:

> (a) Church-related communications capabilities and (b) community-related uses of the system. Among the Church-related communication capabilities are:
>
> 1. National and regional teleconferencing for Church organizations.
>
> 2. Data and facsimile transmission of the Church's national news service to the 150 newspapers of the American Catholic press.
>
> 3. In-service training for specialized Catholic social service organizations, for example, schools, hospitals, Catholic charities, etc.
>
> 4. Electronic message and related internal digitalized communications.
>
> The community-related uses include:
>
> 1. Educational programming services to local cable systems.
>
> 2. Specialized community-related digital services. (For example, CAT scanner interconnections to regional centralized computer facilities. . . . )
>
> 3. Regional teleconferencing for civic organizations.
>
> 4. Inter-connection for national, non-profit, educational/cultural/inter-religious organizations (via cost-sharing arrangements).

Id. at 4. The growth projected by the USSC is difficult to categorize. Data subsequently submitted by the Catholic Television Network [15] show that 11 Catholic Dioceses are now operating systems that use 108 channels. The 11 systems reach 28% of the U.S. population. Another 7 Dioceses are building systems that will use 84 channels and serve 9% of the U.S. population. Thus, the 18 Diocesan systems either in existence or under construction use 192 channels to serve 37% of the U.S. population. Contrasted with these data are the data concerning the 60 Diocesan systems to be constructed in 2 to 5 years for CTN. These 60 systems will require 720 channels to reach 30% of the U.S. population. On the basis of these figures, it can be concluded that much of the growth projected by USCC will occur in areas where ITFS channels have traditionally been most underutilized.

39. In addition, it is not clear what is encompassed by each of the uses listed. It appears that some of what is to be transmitted is not "instructional and cultural material . . . for the primary purpose of providing a formal education and development to students enrolled in accredited public and private schools, colleges and universities" as required by §74.931(a) of the rules, 47 CFR §74.931(a). Furthermore, much of the demand projected by CTN will not occur for many years, and when it does occur it will be concentrated in those areas where

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[15] On February 7, 1983, the Catholic Television Network (CTN) submitted a document titled "Information Indicating Current and Projected ITFS Utilization by Catholic Dioceses" and simultaneously requested pursuant to §1.41 of the rules, 47 CFR §1.41, that the information be made part of the record in this proceeding and in the proceeding in General Docket 80-113. The information submitted by CTN on February 7, 1983 is hereby accepted in this proceeding and in General Docket 80-113. This action is taken pursuant to §1.415(d) of the rules, 47 CFR §1.415(d).

ITFS channels have been underutilized. Thus, it appears that even if all the channel requirements projected by CTN do materialize it is most likely that sufficient channels will be available to meet the projected demand regardless of the reallocation authorized by this order.

40. Finally, the Association of Hospital Television Networks (AHTN), a national non-profit consortium whose 32 members operate or are planning to operate systems to provide instructional programming for health professions, indicated that although not all these systems use ITFS frequencies to distribute their programming, it is expected that some of the systems not yet constructed will use ITFS channels if they are available. Comments of the Association of Hospital Networks, General Dockets 80-112 and 80-113, (July 2, 1982).

41. The growth of ITFS channel use during the pendency of this proceeding has been robust. As noted above, just after this proceeding was started Centex reviewed ITFS channel use and determined that there were 82 ITFS systems using 492 channels. Our own analysis conducted approximately two years later showed that there were 124 ITFS systems using 808 channels. Thus the number of ITFS operators has grown by approximately 50% and the number of licensed channels has grown by over 60%. In addition, as of October 1982, we had 183 applications pending for new construction permits. 16/ As discussed below, many in the MDS community have expressed the view that this growth was triggered by our instituting this proceeding. This may or may not be accurate. In any event, if an applicant is eligible and otherwise qualified and intends to use the spectrum for the purposes stated in our rules, we have no basis to question its motivation for deciding to proceed at any particular time.

42. On the basis of the above, the following conclusions can be made. It is likely there will be an increase in demand for ITFS channels for use by institutions of higher education for the delivery of graduate level training to the workplaces of engineers, scientists, and other professionals. There is less evidence that there will be substantial growth of ITFS use by elementary, junior high, and high school systems. There is also some evidence that there will be growth in the delivery of health services information, but such growth is not likely to be substantial. It also is likely that growth projected by CTN that is appropriate for ITFS will occur in areas where ITFS utilization already is low. Finally, in a companion Notice adopted today, we are proposing to relieve ITFS licensees of a number of regulatory burdens thereby encouraging the fuller use of the ITFS channels.

### 4. Projected MDS Growth

43. It is very difficult to make predictions about the future growth of MDS. In the Notice, the Commission observed that in the 50 major markets and in many of the secondary markets further acceptance of MDS applications is precluded by the cutoff rules. Notice, supra at para. 19. As noted above, there are mutually exclusive Channel 1 applications pending in 84 cities and mutually exclusive Channel 2 applications pending in 42 cities. Thus there are no MDS channels available for growth in any major metropolitan, and many non-metropolitan, areas of the country. Furthermore, unless the mutually exclusive applicants reach an agreement among themselves, a comparative hearing is required to resolve each mutually exclusive situation.

44. The principal factor that most of the MDS entities commenting in this proceeding cited as limiting the growth of MDS is the lack of a multichannel capability. Virtually every member of the MDS community that filed comments in this proceeding expressed the view that if MDS is to survive as an industry, multichannel operation is an absolute necessity. These views were summarized in the comments submitted by the Ad Hoc Committee for Wireless Cable which argued "the expansion of existing MDS service to a multichannel, over-the-air delivery in competition with cable and other forms of distribution is essential to the continued viability of the MDS

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16/ About 120 of the applications were filed by the Public Broadcasting Service (PBS) and its member stations to provide what PBS terms a National Narrowcast Service. Whether PBS is eligible to be an ITFS licensee is presently under review.

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industry and of its existing carriers and operators." Comments of the Ad Hoc Committee for Wireless Cable, General Dockets 80-112 and 80-113, at 3 (July 2, 1982). This claim is especially noteworthy because the Committee is made up of "representatives from substantially all the Carriers and Operators in the MDS Industry." Id. at 2. 17/ In addition, Microband and others have submitted data in this proceeding to support the proposition that there is a large unmet demand for multiple channels of premium television that is unlikely to be met by cable television or any other available technologies. (See paras. 57-64, infra). Microband also submitted studies which it claims establish that the per channel cost for a 5 channel system will be 60% less than for a single channel system because of common equipment and operations. It argues that consumer appeal increases substantially when the number of channels increases but the cost is not substantially higher. Microband Proposal at 57-72.

45. There are two reasons why there is only one multichannel MDS system in operation today. The first reason is, of course, that there are not enough channels available to allow multichannel operation. As noted above, there are only two MDS channels capable of transmitting a standard television signal available in the top 50 markets. Outside of these markets there is only one such channel available. Furthermore, in most of the top 50 markets, a comparative hearing may be required before the second channel is licensed. Even when it is licensed there will be very limited opportunity for even two-channel MDS operation. In general, this appears feasible only if the same operator becomes the customer of both licensees as has occurred in Phoenix (paragraph 30, infra).

46. The other reason is that §21.901(d) of our rules, 47 CFR §21.901(d), precludes a licensee from obtaining a second channel in the same metropolitan area until it has operated the first channel for at least one year and can show that there is a public demand for additional service that is not likely to be met by a competing carrier. In the Notice, the Commission proposed to repeal this rule and it will be discussed below. The rule is pertinent here because it has been shown to be an impediment to MDS growth. Except for this rule, existing Channel 1 licensees would be better able to work out arrangements with the Channel 2 applicants that would facilitate 2-channel operation. Or the same entity could have applied for both channels and offered 2-channel service to one customer or offered one channel service to two customers.

47. On the other hand, as was observed in the Notice and by most of the ITFS commenters in this proceeding, the fact that there are a large number of applications for authority to construct MDS stations does not necessarily mean there is an unmet demand for MDS service. In fact many have claimed that the MDS applications on file are merely a reflection of a "land rush mentality" rather than real demand. Typical of these comments was the view that:

> "demand for MDS channels, manifested through applications filed with the Commission and the demand for MDS service, are two entirely different things. Many MDS applicants, like land speculators, are applying for spectrum with no certain knowledge of what they would do with an MDS channel and, in many cases, with no immediate plans for using any MDS channel which may be granted to them."

Comments of the Association for Higher Education of North Texas, et al., General Docket 80-112 and 80-113, at 14 (July 2, 1982).

48. Many members of the ITFS community submitting comments regarding MDS channel use and projected growth did so on the basis of information supplied by Centex. For this reason, we believe it is appropriate to comment on the Centex MDS analysis. Centex submitted an analysis of the growth of MDS from 1972 thru 1980 that Centex claims "points to fundamental errors in the FCC analysis of MDS channel needs." Centex Comments, supra, Attachment C, 12. Centex

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17/ The Committee is made of both licensed MDS carriers and the MDS operators who are the customers of the licensees. The carriers represent more than 80% of the existing or potential MDS licensees in the top 50 markets and the operators provide programming for 70% of all active MDS channels. Ad Hoc Committee Comments, supra, 2 and 1.

claims that during this period a total of 1,771 MDS applications of various types were filed. Centex also states that "there are, in fact 21 different types of applications listed by the FCC, of which only 8 deal directly with construction permits and licenses, while 13 deal with modifications or additions. The FCC dockets fail to make this important point clear." Id. The Centex data shows that of 1,771 applications filed 1,137 were for construction permits and 102 were for station licenses. Because of this Centex exclaims "the number of applications for licenses for new stations is, however, only 102 or 5.8% of all applications!" Id. at 13 (emphasis in original). The Centex data also shows that of a total of 239 channel 2 applications, only 2 were for licenses. On the basis of this data Centex makes the following assertion:

> "Since serious operators – both profit and non-profit entities – usually aggressively pursue their applications for construction permits and assiduously pursue station construction authorizations, one could rightly ask, why has this not occurred in the case of MDS? Is it because applications are being made on the basis of Oklahoma-type land-grabs with the hope that valuable 'mineral' or 'farm lands' may be acquired? Regardless of the basis for the current status of MDS applications, the fact that only 1 of every 14, or 7%, of all MDS channel applications has developed into an FCC-licensed operation is indicative of the real status of MDS." Id. at 14.

49. We recognize and appreciate that Centex is the most reliable private source of ITFS facility data; however, we believe that these comments suggest a misunderstanding of the MDS industry and Commission processing procedures on Centex's part. When an entity desires to construct a MDS facility it submits a construction permit application to the Commission. If the application is not mutually exclusive with another construction permit application and is complete in all respects and if the Commission finds that the applicant is legally, technically and otherwise qualified, the Commission will grant the requested construction permit. After the permittee constructs the station it will then apply for a station license. As is clear from the statistics quoted by Centex, there are many more construction permit applications than there are channels available and thus most of the construction permit applications received are mutually exclusive with at least one other application. None of these mutually exclusive applications can be granted until either a comparative hearing is held or the mutually exclusive applicants reach a satisfactory settlement agreement. This situation accounts in part for the slow growth in the number of MDS stations. 18/

50. It also may be that there is some truth in these assertions. It does appear that in many areas the development of MDS has been slow (see para. 28, supra). The data submitted by MDS interests suggest that the marginal cost of providing additional channels is sufficiently low that additional penetration could be anticipated were multichannel operations authorized (see para. 44, supra).

51. On the basis of the information presented, we conclude that there will be little growth in the use of MDS channels as long as there are only two channels available and each licensee is only allowed to use one channel per metropolitan area (see para. 44, supra). The market for single channel MDS in many areas is limited (see para. 28, supra). We further conclude that if more channels were made available and if the restrictions on multiple channel operation are removed there could be a rapid acceleration in the growth of MDS.

### B. Public Policy Considerations

52. Several ITFS commenters in this proceeding claimed that even if the ITFS channels are not now fully utilized, as a matter of public policy, the Commission should continue to keep

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18/ The Centex comments also included a table that represented a statistical comparison of MDS, OFS, and ITFS. In this table, Centex claimed that 98 MDS stations served a total of 133 receive sites with an average 1.4 receiving sites per installation. Id. at 19. It is not clear where Centex obtained these figures, but it is clear that they represent a gross misstatement of MDS channel use. According to the figures compiled by Paul Kagan Associates, Inc. as of June 30, 1980 the MDS industry was providing premium television service to 352,000 individual locations. MDS Data Book, supra, at 12. It may be that what Centex did in its analysis was confuse the number of entities purchasing time from MDS stations with the number of locations receiving service via MDS. In the usual MDS situation there is a single MDS licensee with a single subscriber who provides service to a large number of customers.

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all 28 channels reserved for ITFS. For example, the American Library Association asserted that "as a matter of public policy the Commission should retain this spectrum for noncommercial educational use. As the guardian of the airwaves for the public, the Commission has a special responsibility – in our judgment – to set aside a portion of the spectrum for the benefit of the public, just as is done in the case of land development in Alaska and the Far West." Comments of the American Library Association, General Docket 80-112, at 3 (September 5, 1980). The National Association of Educational Broadcasters stated that:

> "The growth of instructional telecommunications systems depends on the concept of reservation. Educational and public telecommunication interests should not be forced into the 'marketplace' with commercial and private microwave system operators. The ITFS band is the last 'free' resource available to the country for educational purposes. The Commission maintains the noncommercial reservation of the lower 4 MHz of the FM radio band and of unused assignments in the TV Table of Allocations, despite the pressures from would-be commercial broadcasters to invade this reserved territory. Maintenance of the reserved nature of the 2500-2690 MHz band is also warranted by the same policy considerations."

Comments of the National Association of Educational Broadcasters, General Docket 80-112, 6 (September 26, 1980).

53. We recognize that there are sound public policy reasons for creating spectrum reserves. In the order granting the exclusive use of the 28 channels to the ITFS, the Commission concluded that "[b]y providing the exclusivity desired by the educators, planning of the system as well as usage should be simplified since they will not need to consider the questions of new non-ITFS systems." ITV, supra, at 200. In the same order, the Commission recognized that it should wait longer to review the use of spectrum allocated for educational use "because it was aware of the problems encountered by educational interests in preparing funding and implementing the new tool as well as developing the operational expertise. . . . " Id. at 199. We continue to believe that the concept of a spectrum reservation for educational and other public service entities is valid. We also continue to recognize, as many of the ITFS commenters in this proceeding have again emphasized, that the nature of educational institutions is such that it will generally take them much longer than it would take a commercial entity to begin using a new technology such as ITFS. 19/ It has been pointed out in this proceeding that educators are slow to accept new technologies and that many of the funding sources for education are even slower to make funds available for innovative endeavors such as ITFS. We also note in this regard that in its comments, Microband stated that "[w]hile it might be argued that school systems, which must pay for land, buildings, supplies, electricity and other facilities, should otherwise compete in the free market for these channels, we do not subscribe to such an approach. Instead, we would urge the retention of a number of channels for exclusive ITFS use." Comments of Microband Corporation of America, General Docket 80-112, at 27 (October 9, 1980). We agree. Thus, we continue to believe it is in the public interest to have a spectrum reserve for the ITFS.

54. Deciding that it is the public interest to have a spectrum reserve does not mean, however, that a 28 channel nationwide reserve is in the public interest. In this proceeding, we have tried to determine whether the channels that have been available for the ITFS since 1963 are now being used or will be used in the future. As summarized above, the evidence indicates that in some of the largest metropolitan areas most of the ITFS channels have been licensed. In other metropolitan areas, there has been limited or no use of the channels. In many states, there are no channels in use, and in most of the other states, there is little use outside of the metropolitan area. Although it is difficult to make accurate projections concerning the future use of these channels, the evidence available indicates that there will be some growth, but not enough to fully utilize all the channels on a nationwide basis.

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19/ It could be argued that ITFS can no longer be considered a new technology since it has been available for almost 20 years. However, it is only recently that many of the school systems and universities have become aware of its potential.

55. Having found that there are ITFS channels that are not now being used and are unlikely to be used in the near future, we are faced with the question of whether it would be in the public interest to reallocate some of them for use by MDS as proposed in the Notice. MDS is now used primarily for the distribution of premium television to hotels, motels, apartments and single family residences. In its proposal, Microband submitted extensive evidence that there is a large unmet demand for multichannel premium television and that "cable (television) is not capable of meeting the existing demand . . . now or any time in the foreseeable future." Microband Proposal, supra, at 55. Microband further argues that making more channels available for MDS would act as a competitive spur to the cable television industry and that "[s]ince there are no alternative distribution systems authorized to provide multichannel broadband service, cable has been able to behave as a monopoly industry, building at a schedule suited to its own pace, with little incentive to upgrade antiquated systems." Id. at 12 (footnotes omitted). Microband concludes that an expanded MDS would "provide a competitive spur to cable, thereby moderating its monopoly characteristics and speeding its growth." Id. at 25.

56. On the other hand, most of the ITFS commenters expressed the view that expanding the MDS was unnecessary in view of the number of alternative methods of delivering entertainment programming to the public. The Public Broadcasting Services (PBS) comments were typical. PBS asserted that:

> "Microband's argument that multichannel MDS systems should be used to increase competition for cable television does not justify a departure from the nation's long established and sound policy of assuring adequate telecommunications resources for educational purposes, especially when that competition is provided by numerous other technologies. Nor are mutichannel MDS systems required to fill in service gaps where cable television is not available. With the explosion of STV, and DBS and low power television on the short-term horizon, there will be more than sufficient alternative services available to the public in both urban and rural areas. Low power television and DBS, in particular, have been highly touted as solutions to the problem of underserved rural areas."

Comments of the Public Broadcasting Service, General Dockets 80-112 and 80-113 (June 2, 1982).

57. These comments do not demonstrate that there is no substantial public demand for additional premium entertainment programming. Rather, they address the matter of how the demand should be met. As to the timing of the introduction of other new services, we note that there is no multichannel alternative to cable available now. STV is a one channel service. A high power Direct Broadcast Satellite service, transmitting entertainment programming directly to individual homes on a widespread basis, is several years away. 20/ Low power television as a means for delivering subscription television is basically a low power version of STV. In any case, multichannel MDS will expand consumer options, and expanding consumer options is a legitimate public interest justification for reallocating spectrum. If those who claim there is no market for multichannel MDS are correct then whatever spectrum is allocated for multichannel MDS will go unused and can be reallocated back to the ITFS or to some other appropriate use.

58. If, on the other hand, a market does develop for multichannel MDS there would be benefits to the public at large and there could be large benefits to the users of the ITFS channels as well. For example, in both this proceeding and in the companion proceeding in Docket 80-113, we have been informed by ITFS licensees that there has been no reduction in the cost of the equipment they are being offered by manufacturers. This is in direct contrast to the MDS industry where the cost of the downconversion equipment has decreased from over one thousand

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20/ A number of entities (e.g. United Satellite Communications, Inc.) have announced plans to attempt to use low power fixed satellites to deliver video entertainment programming to individual homes, in addition to traditional fixed satellite reception points (cable television systems, MDS systems, hotels, etc.). The fixed satellite service is at a comparative technical disadvantage vis-à-vis the direct broadcast satellite service because, among other things, the lower power transmitters require larger receive antennas and the satellites are spaced more closely together which increases the possibility of interference. In any event such systems are nascent in design and may be subject to further regulatory considerations.

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dollars to less than one hundred dollars. We believe that if there is widespread use of multichannel MDS there could be similar reductions in the cost of ITFS equipment. These savings would result from economies of scale in the manufacture of reception equipment. This could result in dramatic decreases in the cost of constructing ITFS systems thereby making them affordable to many who cannot now afford to build these systems. 21/ Lower cost ITFS reception equipment could also make it possible for existing ITFS systems to expand the market for their programming. It could become economically and technically feasible to deliver instructional programming directly to private homes.

59. Microband further claims that authorizing multichannel MDS would be in the public interest because it would "promote economic activity in a high technology field which is important to the nation's future." Id., at 73. Microband estimates that the authorization of the multichannel MDS could provide 20,000 new jobs. Id. Bogner Broadcast Equipment claims that the authorization of multichannel MDS would cause equipment manufacturers such as itself "to develop new, improved and competitively priced multichannel reception equipment." Bogner further claims that "the stimulus will have a ripple effect throughout the industry benefitting manufacturers, marketers, retailers, MDS licensees, MDS programmers, and most of all the consumer." Comments on Proposal, Bogner Broadcast Equipment Corporation, General Dockets 80-112 and 80-113, at 2 (June 2, 1982). Other equipment manufacturers have expressed similar views. Conifer Corporation asserts that authorization of multichannel MDS "will create new business opportunities and will benefit the economy." Comments on Proposal, Conifer Corporation, General Dockets 80-112 and 80-113, at 2 (June 2, 1982). Lance Industries states that authorizing multichannel MDS "will cause a re-vitalization of a significant segment of the American-based electronics manufacturing industry" and thereby "create jobs and benefit society as a whole." Comments in Support of Rule Making Proposal, Lance Industries, General Dockets 80-112 and 80-113, at 2 (May 28, 1982).

60. Another public interest argument made by some commenters is that authorizing multichannel MDS will make multiple premium television channels available to rural areas that may never be served by conventional cable television. One citizen from West Virginia made the following observation:

> "Any survey of rural America will demonstrate that the presently allocated instructional television fixed channels are not being used or are used only in a minimal fashion in rural areas. The likelihood that a multi-channel MDS service would impinge on the availability of such channels for instructional purposes is most remote at best.
>
> "I really believe that it is about time that your agency give as much consideration to expanding various electronic services to rural America as you give to increasing the plethora of electronic services that are available in the larger markets."

Informal comment of S. Craig Curtis, General Dockets 80-112 and 80-113 (May 8, 1982). An MDS operator from New Hampshire surveyed potential multichannel MDS customers and submitted the following summary of the responses received:

> "Most of these residents cited a recent article that appeared in the newspapers concerning a small town that was considering Cable Television, wherein one of the politicians stated that 'Only 50% of the residents in the State of New Hampshire will ever have Cable Television Service.' Their general reaction to this article is that when an electronic type of service is available to provide them with this service, which will not cost the taxpayers any additional money and will actually employ more people in the State, why should they be deprived of this service simply because they choose to build their home and raise their family in a suburban type of atmosphere? Others expressed views that they realized that it was more costly for their water, sewage system and fire insurance rates where their homes have been erected, but their reaction was, 'Isn't this what the United States is all about – Freedom of choice?' And they felt as long as they were willing to pay the cost for their freedom, the FCC should provide them the same equal opportunity that is provided to those who have elected to live in a large city, provided the cost is paid for by themselves, and not the state or government."

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21/ This does not argue against reallocation of a portion of the band to MDS because the premise of the reallocation is based on commercial operation.

Comments of Dynamic Sound, General Dockets 80-112 and 80-113, at 3 (June 1, 1982).

61. Two major public interest arguments favoring the authorization of multichannel MDS are efficiency and flexibility. It is clear that substantial demand exists for multichannel premium television service. In uncabled areas (some of which may never be cabled), multichannel MDS is a means for satisfying consumer demand for additional premium television service. In areas that are or are about to be cabled, competition from multichannel MDS may spur cable systems to build promised systems faster, improve existing systems, and keep prices low. The efficient production of goods and services and the efficient use of spectrum are promoted when competition among providers is present.

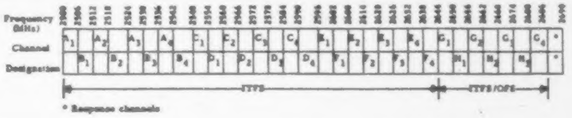
62. Multichannel MDS is also a particularly flexible service. While current indications are that its primary use would be for premium video, many other uses are possible (e.g., high speed data transmission or transmission of educational programming). The common carrier nature of MDS means that the type of service provided can change on public demand. Thus, the frequencies authorized for multichannel MDS use are likely to be employed in their highest valued use.

63. In addition to these two advantages, it is also possible that multichannel MDS would stimulate equipment innovations that would lower the cost of ITFS equipment. This could make ITFS service more widely available.

64. The major argument raised in opposition to the reallocation, other than the spectrum reservation argument discussed above, is that multichannel MDS is not needed because there are other technologies available to meet whatever demand exists. After carefully considering all these arguments, we have concluded that reallocating some ITFS channels to MDS will serve the public interest. We believe the benefits noted above are sufficently likely to permit MDS entrepreneurs an opportunity to expand consumer choice by offering a multichannel MDS service. Should these benefits not materialize, a further reallocation may be undertaken. We do not believe our reallocation plan, discussed below, compromises the legitimate needs of the ITFS community for channels of communication.

### C. Reallocation Plans

65. Before reviewing the reallocation plans considered, we believe it is useful to review the existing allocation scheme used for the 2500-2690 MHz band. The band is divided into thirty-one 6 MHz channels and the same number of 125 kHz response channels. 22/ (The final 125 kHz of the band is not allocated for these services.) The thirty-one 6 MHz channels are contained in the portion of the band from 2500 MHz to 2686 MHz and the thirty-one 125 kHz response channels are contained in the band from 2686 MHz to 2689.8750 MHz. The thirty-one 6 MHz channels are further divided into 7 groups of 4 channels each and a single group of 3 channels. The 4 channel groups are designated channel groups A through G and are assigned to the ITFS. The 3 channel group is designated the H group and is assigned to the OFS. Within each group there is a 6 MHz gap between each of the channels. That is, channels within each group are not adjacent; they are alternated with those of another group to provide a 6 MHz guard band between the channel within each group. The chart below illustrates the allocation plan.



66. ITFS licensees are limited to no more than 4 channels in a single area, all of which must come from the same group. 47 CFR §74.902(c). If an applicant is not ready to use all four channels when it first applies, it may request the remaining channels be reserved for it for future use. Id. In those situations in which there are two ITFS licensees in the same area, the channel groups are assigned insofar as is possible so that there is no adjacent channel

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22/ The response channels are used by some existing ITFS channels to allow students in the remote classrooms to speak with the instructor at the studio. Other systems use telephone lines for this purpose and their response channels are unused.

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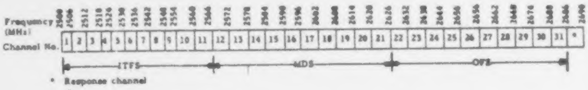
operation. For example, if there were an A group licensee in a given area, we would try to avoid granting a B group license in the area. It should also be pointed out in this regard that our rules provide for reusing channels in the same area if doing so would not cause harmful interference. 47 CFR §74.902(d).

67. The principal reason for adopting the present scheme was that it allowed the use of simple and inexpensive reception equipment. Instruction Television Fixed Service, 2 RR 2d 1615 (1964). The equipment used to receive an ITFS signal consists of an antenna, a downconverter and a conventional television receiver. The downconverter simultaneously converts the incoming signals from the four ITFS channels (if four channels are being transmitted) to four VHF television channels. The VHF channels used are usually either 7, 9, 11 and 13, or 8, 10, 12 and 13(+). 23/ Which set to use is determined by which VHF channels are used in the area. This eliminates the possibility of the VHF stations interfering with the downconverted ITFS channel. It also allows the local television channels to be distributed on the same cable as the downconverted ITFS channels. Id. at 1617.

68. In the Notice, we proposed a plan whereby the 31 channels in the 2500-2690 MHz band would be reallocated for shared use by the ITFS, the MDS and the OFS. Under this plan there was to be a primary allocation of 11 channels to the ITFS, 10 channels to the OFS, and 10 channels to the MDS. We also proposed that if the primary allocation of a service was fully used in one area any unused channels in the other two allocations could be used to satisfy the excess demand in the fully used service. The proposed plan did away with the channel groups described above and replaced them with contiguous allocations. The chart below illustrates the proposed allocation plan.



69. This plan received virtually no support from the commenters in this proceeding. It was criticized as being technically not feasible and unduly disruptive of the existing ITFS allocation scheme.

70. The claims that it was technically not feasible were all based on the belief that adjacent channel operation cannot readily be achieved. Several reasons were given to support the claim. First, some claimed that adjacent channel operation would preclude the use of the block downconversion equipment now used by virtually all ITFS systems. One of the major advantages of the block downconversion technique is that it "avoids interference created from 'direct pickup' of a VHF television station by the television receiver, or by a 'MATV' system used to distribute converted ITFS signals to school classrooms." Further Comments of the Corporation for Public Broadcasting, General Dockets 80-112 and 80-113, Engineering Statement, at 5 (July 2, 1982). If adjacent channel operation were required, the local VHF television signal would be picked up by the television receiver being used to display the ITFS signal and cause a degraded picture. CPB outlined a downconversion scheme that would mitigate this problem but that would also produce another problem, interference with the reception of the local VHF signals carried on the same distribution system. Id. at 6. The equipment required to implement the downconversion scheme was much more complicated and expensive than existing ITFS downconversion equipment.

71. CPB also mentioned two other problems that could occur with adjacent channel operation: unavoidable unauthorized reception of the adjacent channel programming and downconverter

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23/ The designation 13+ refers to the use of the spectrum immediately above Channel 13. This is made possible by adjusting certain circuits within the television receiver. Further Comments of the Corporation for Public Broadcasting, General Dockets 80-112 and 80-113, Engineering Statement, at 6 (July 2, 1982).

overloading. Id. at 2. The unauthorized reception referred to by CPB would occur when different licensees were using interleaved channel groups. For example if one ITFS licensee were using the A group and another ITFS licensee were using the B group in the same area, the block downconversion equipment used at the receiving sites of both licensees would be capable of receiving programming from both licensees. The other problem raised by CPB, downconverter overloading, could result if 8 strong signals were received at a single location from two nearby ITFS stations. CPB claims that the presence of eight signals in the downconverter would produce intermodulation interference to both systems.

72. Notwithstanding the theoretical merits of CPB's criticisms, we note that there are many large metropolitan areas where interleaved channel groups are being used. For example, the A and B groups are licensed in Los Angeles, San Francisco, New York and Milwaukee, and we have received no reports of the problems raised by CPB. This is not to say that problems do not exist, but we can only assume that they are not great since we have not received any reports of this arrangement producing problems.

73. Another commenter claimed that adjacent channel operation would eliminate the ability of ITFS operators to use the same transmitter for both the aural and the visual channels as is done now and force them to the expense of using a separate transmitter for each channel. It was claimed the present "mode of operation simplifies the transmitter and makes it less expensive but also complicates the suppression of energy outside the particular channel transmitted." Comments of National Instructional Telecommunications Council, Inc. and Catholic Television Network, General Docket 80-112, Attachment H, Engineering Statement by Jules Cohen & Associates, at 2 (July 26, 1980). According to Mr. Cohen single transmitter operation would produce so much interference that adjacent channel operation would be impossible. Finally, Dr. William Kincheloe, Jr., Adjunct Professor of Electrical Engineering at Stanford University concludes, "that such a major change in policy for frequency allocations as that proposed by the adjacent channel assignment in Docket No. 80-113 should be done with great care if a situation is not to develop where many instances of degraded service would be experienced to the embarrassment of the FCC." Comments of the Leland Stanford Junior University, Attachment A at 6 (September 26, 1980).

74. These and other commenters are only claiming that the adjacent channel operation that was implicit in our proposal is not technically feasible using existing ITFS equipment. None has claimed that such operation is not technically feasible using state-of-the-art engineering practices. In fact, the Corporation for Public Broadcasting made the following claim in its first set of comments:

> "With present state-of-the-art engineering practices, it is no longer necessary to restrict distribution systems to alternate channels. Primarily by careful control and maintenance of signal strength ratios, systems can be constructed to successfully utilize adjacent channels, as in the now common cable television distribution systems where all 12 VHF channels are filled."

Comments of the Corporation for Public Broadcasting, General Docket 80-112, Appendix 1, at 57, n. 1 (September 26, 1980).

75. In its proposal Microband expressed some doubt about adjacent channel operation using existing MDS equipment. It stated:

> "We rejected a scheme which would make use of a block of contiguous channels all operating on the same polarization. The major difficulty associated with this plan is not knowing what the adjacent channel interference performance of such a system would be. Existing equipment type accepted for MDS and ITFS operation would not be capable of operating without significant adjacent channel interference because the vestigial sideband attenuation required by paragraph 73.687 of these rules does not provide for sufficient isolation between adjacent channels. Thus, without additional isolation provided by orthogonal polarization operation and/or a significant increase in the vestigial sideband filtering, interference-free adjacent channel operations will not be possible."

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Microband Proposal, supra at 33 n. 37 (emphasis added). Contrasted with Microband's view was that of Richard Vega who claimed that "the transmisison of copolarized adjacent channels can easily be accomplished by relatively *simple and inexpensive modifications* to existing type accepted MDS transmitters." Comments of Richard L. Vega. General Dockets 80-112 and 80-113, at 5 (July 2, 1982) (emphasis added) Mr. Vega further claims that the multichannel experiment being conducted in Salt Lake City supports this claim. Id. 24/ In its comments, Contemporary Communications Corporation (CCC), while agreeing with Microband's claim that the existing MDS and ITFS transmitters will not allow adjacent channel operation, contends that "state-of-the-art transmitters are readily available today whose technical specifications will permit adjacent channel operation using the same polarization without causing interference." Additional Comments of Contemporary Communications Corporation, General Dockets 80-112 and 80-113, at 19 (July 2, 1982). CCC also suggests that modifications of some sections of the rules would make adjacent channel operation easier. Id.

76. Many ITFS operators have claimed that even if adjacent channel operation were technically feasible the costs of the necessary equipment changes would be prohibitive. For example, the University of Southern California stated "the suggested channel reallocation would entail significant additional costs which educational institutions in their present financial circumstances, can ill afford." USC further argued that "[a]ny new allocation schemes that would increase the technical complexity of existing ITFS equipment would undermine the very basis upon which the low cost educational use of ITFS was originally promoted." Comments of the University of Southern California Instructional Televison Network, General Docket 80-112, at 3 (September 29, 1980).

77. Many of the existing ITFS licensees claimed that the proposed plan would result in substantial reductions in the service they are now providing. For example the California Public Broadcasting Commission (CPBC) claimed that if the plan in the Notice were adopted "there would be a net loss of two-thirds of the channels now operating or imminent in Los Angeles, San Francisco and San Diego," and "that California's principal cities will face massive reductions in their present ITFS service. . . . " Comments of the California Public Broadcasting Commission, General Docket 80-112, at 7 (September 26, 1980). We are aware that these California cities represent areas of unusually heavy ITFS channel use, and that there is some validity to the concerns that our initial proposal could cause dislocations or additional expense.

78. On the basis of these considerations, we have reached the following conclusions regarding the reallocation plan in the Notice. Adjacent channel operation is technically feasible but it can only be implemented using transmission and reception equipment that is different from existing ITFS equipment. We believe implementation of the allocation plan in the Notice would be expensive and would put an undue financial burden on existing ITFS licensees. 25/ Furthermore, the plan would be disruptive of many existing and planned ITFS systems. For these reasons and since we have concluded that there are less disruptive methods to make spectrum available for MDS use, we have concluded that adoption of the allocation plan in the Notice would not be in the public interest.

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24/ On December 3, 1981, the Commisson granted Channel View, Inc. an experimental station license to test the technical feasibility of transmitting eight adjacent channels from a single site. The station is designated KM2XBN. File No. 866-ED-PL-81. The early results submitted by Channel View indicated some difficulty in reducing the spurious emissions from the transmitter more than 60 dB below the peak visual transmitter output; however, subsequent design adjustments in the transmission equipment have solved this problem and the tests have demonstrated that operating an 8 channel system using adjacent channels appears to be technically feasible. Channel View subsequently sought permission to conduct a "market experiment" using these frequencies. File No. 8938-ED-MR-82. In particular, Channel View requested authorization to program its multichannel system with premium programming and to provide service to the public for profit. The original experimental authorization prohibited Channel View from offering multichannel service to the public for profit. In view of our action reallocating spectrum, a market experiment would serve no useful purpose and that portion of Channel View's application therefore is denied.

25/ It is difficult to make precise estimates of the costs that would be incurred in converting existing ITFS systems to adjacent channels systems. It is likely that in most situations the

[Footnote continued on following page]

79. The Notice also discussed other allocation plans. One was that each service be allocated specific channels within the band. We rejected that plan for two reasons. First, it required us to make predictions concerning the future needs of the services, a prediction we felt unable to make at the time. Second, we felt that such a plan would not be flexible enough to deal with regional variations in the number of channels required for the services. For these reasons, we proposed the primary allocation plan that allowed sharing of unused channels by the other two services. As articulated above, the voluminous record in this proceeding has enabled us to develop a better sense of the future growth of these services. It also has demonstrated that our concerns about regional variations were valid. There are wide regional variations in the use of both MDS and ITFS.

80. We also considered the alternative of unlimited sharing of the band by all three services. We rejected this plan because we believed it would be difficult to administer, especially if different technical rules were applied for each of the services sharing the band. After reviewing the record in this proceeding, we have also concluded as set out above, that such a plan would be contrary to the public interest in that it would not insure that some spectrum would continue to be reserved for potential ITFS applicants.

81. On the basis of these conclusions, we have reviewed the reallocation options available and have concluded that a plan that considers regional variations in spectrum use while at the same time reserving some channels for potential ITFS applicants would best serve the public interest. Several of those commenting in this proceeding also expressed the view that an allocation plan that reflected regional differences in spectrum use also made more sense than a uniform nationwide plan. See Comments of Oklahoma State Regents For Higher Education, General Docket 80-112 (June 16, 1980); Comments of C. Peter Magrath, President, University of Minnesota, General Docket 80-112, 3 (September 29, 1980); Comments of the State University of New York, General Docket 80-112, 4 (September 24, 1980).

82. We have considered various methods to take into account the regional variations in the demand for ITFS stations and multichannel MDS. One method suggested by President Magrath of the University of Minnesota was to hold local or regional public hearings to determine, inter alia, "the views of the community affected concerning the merits of the existing and proposed services." Comment of the University of Minnesota, General Docket 80-113 at 3 (September 5, 1980). Such public hearings could also be used to get accurate detailed information on the projected demand for ITFS channels and the demand for multichannel MDS for each area. We believe that holding such hearings would be a lengthy and expensive process, requiring a substantial amount of travel and administrative support. We do not believe that such a procedure is feasible and even if it were we do not believe that results obtained would be so substantially better than those obtained by other methods as to justify the expense and delay involved.

83. We have also considered reallocating channels to provide multichannel MDS only in those areas where there has been little or no use of the existing ITFS channels. Proceeding in this manner has two distinct disadvantages. First, it could involve the Commission in a protracted process to determine the boundaries of such areas. The only realistic way this could be done would be to wait until a multichannel application was received and then determine the ITFS channel use within a specified distance of the proposed MDS station. Only after conducting such an analysis could we accurately determine ITFS channel use in the proposed MDS service area. Of course, we could require MDS applicants to include this analysis as a part of their applications. This would likely cause many existing and potential ITFS licensees to challenge the accuracy of the MDS applicant's analysis thereby involving the Commission staff in a series of contested proceedings. This would clearly delay the introduction of multichannel service in many areas.

84. The other difficulty with such a plan is that there would be little possibility of multichannel MDS in those metropolitan areas where the ITFS channels are extensively used. Thus, even where existing ITFS licensees were willing, or even desired, to transfer their license to an MDS operator, MDS operations would not be permissible.

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25/ [Footnote continued from preceding page]

existing transmitters would need to be replaced at a cost in excess of $100,000 per transmitter. It is also possible that existing downconverters would need to be replaced or modified. The total cost involved would be a function of the number of receiver sites and the cost per site could be several hundred dollars.

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85. The plan we have settled upon takes into consideration regional variations in ITFS channel use, "grandfathers" all existing ITFS licensees, permittees, and applicants and reallocates a specific set of channels for MDS use on a strict noninterference basis. The plan works as follows:

a. The E and F groups are reallocated for multichannel MDS use on a nationwide basis.

b. A multichannel MDS permittee will not be authorized to begin construction until it submits a statement from all existing cochannel and adjacent channel ITFS users with transmitters located within 50 miles of the new MDS station that the operation of the multichannel MDS station will not interfere with the ITFS operation or that the ITFS operator would accept any interference that did occur. This means that the MDS permittee is authorized to negotiate with existing cochannel and adjacent channel users of the ITFS channels to attempt to reach an accommodation whereby the needs of each can be satisfied. In those cases where there are no ITFS operators within 50 miles of the proposed MDS transmitter location that are using the authorized channels or any adjacent channels, the MDS permittee must so state. 26/

c. All ITFS licensees and permittees of, and applicants for, the channels as of the adoption date of this order will be grandfathered with rights of renewal. That is, all ITFS licensees of E or F group channels will be allowed to renew their licenses. Furthermore, all permittees of and applicants for either E or F group channels that ultimately obtain a license will be allowed to renew such licenses. No assignments, other than pro forma assignments of ITFS E or F group licenses, applications, or construction permits will be authorized.

d. No new ITFS applications for the E or the F group channels filed after adoption of this order will be accepted.

86. The elements of this plan have several advantages that other plans lack. Reallocating a specific set of channels on a nationwide basis means that in those areas where the reallocated channels are not being used, channels will be immediately available for multichannel MDS. It also creates at least the possibility that multichannel MDS will be available even in those areas where the reallocated channels are being used by ITFS service providers. It does this by granting conditioned construction permits for multichannel MDS in such areas and allowing the holders of these construction permits to negotiate with the existing cochannel and adjacent channel users to attempt to reach an accommodation whereby the requirements of both can be met.

87. We expect that such negotiations would consider, inter alia, the relocation of the existing ITFS users to other available ITFS channels, the use of frequency reuse techniques such as cross-polarization, site shielding and frequency offsets, and even the possibility of satisfying some of the communication requirements of the existing ITFS users in other areas of the spectrum. In this regard, we note that some members of the MDS community have argued that ITFS channel use is inefficient in the large metropolitan areas. For example, in its proposal, Microband claimed that many of the licensed ITFS channels were being used for point-to-point communication rather than for omnidirectional communication and concluded that, "[t]he significance of these point-to-point uses is that when intermixed with an intended omnidirectional use, they lead to a significant waste of spectrum." Microband Proposal, supra, Appendix H, at 6.

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26/ We expect existing and potential ITFS operators to cooperate with MDS permittees in determining whether the operation of the MDS facilities will interfere with the ITFS operators. If the MDS permittee is not able, after making reasonable efforts, to obtain the desired statement from the ITFS operator it may submit evidence to the Commisison on the issue of whether harmful interference will occur. The MDS permittee must also detail the efforts it made to obtain the desired statement and must serve a copy of all evidence submitted to the Commission to all affected ITFS operators. We expect such submissions to represent extraordinary cases.

In his first set of comments, Richard L. Vega concluded that, "[i]n many cases, the ITFS authorized channel is for point-to-point microwave service thereby creating a wasteland of co-channel and adjacent channels over a relatively large geographical area due to the potential harmful interference." Comments of Richard L. Vega, General Docket 80-112, at 2 (September 30, 1980). In many cases, the use of ITFS channels for point-to-point communications is complementary to point-to-multipoint or omnidirectional use in the same area. The point-to-point use of the ITFS channels is usually for studio to transmitter links (STLs). For example, under the proper set of circumstances, it could be possible to use one group of a pair of interleaved channel groups in an omnidirectional configuration and to use the other group as an STL in the same area. Furthermore, the use of an ITFS channel group for point-to-point communications allows the ITFS operator to use simpler and less expensive equipment than would be required by conventional point-to-point service. Finally, of course, such use is specifically provided for in §73.931(d) of the rules, 47 CFR §74.931(d). We do believe, however, that it may be possible to accommodate such users in other portions of the spectrum. In regard to these negotiations, we would expect the multichannel MDS permittee to give reasonable compensation for any dislocations caused by the operation of its facilities.

88. Another advantage to reallocating a specific set of channels and requiring an agreement prior to construction of the multichannel facilities is that it is easy to administer. This is in a sense a double advantage. It makes it easier for applicants to file acceptable applications and makes it easier for the staff to review the applications. Under this plan, an applicant is not required to conduct an interference analysis until after he has received an authorization. Thus, all applicants are expected to comply with all pertinent Sections of Part 21 including those we are adopting today except that they are not required to show non-interference with existing and proposed cochannel and adjacent channel ITFS users of the reallocated channels until after a construction permit has been granted. This procedure will save unsuccessful applicants the time and expense required to prepare such analysis and it will save the staff the time required to review each analysis submitted. Furthermore, we expect that the analyses that are submitted by permittees will be of a much higher quality than those submitted by applicants. Another administrative advantage is that under all of the other plans considered it may have been necessary to freeze the acceptance of all further ITFS applications for some period of time. This plan does not require such a procedure because it does not change the application process for the twenty channels still allocated for ITFS use.

89. A final advantage to a uniform nationwide allocation for multichannel MDS is that it avoids, to the greatest extent possible, disrupting the authorized satellite use of the 2500-2690 MHz band. The use of the band by the broadcast satellite service is limited domestically "to domestic and regional systems for community reception of educational televison programming and public service information." 47 CFR §2.106, n. NG 101. The bands 2500-2535 MHz (space to earth) and 2655-2690 MHz (earth to space) are also shared with the fixed satellite service for common carrier use in Alaska and certain areas in the Western Pacific and in the contiguous United States, Alaska and the Mid and Western Pacific areas for education use. 47 CFR §2.106, n. NG 102.

90. Several of those filing comments in this proceeding suggested that if we were to reallocate spectrum from the ITFS use to the MDS use we would reduce the possibility of any satellite service sharing the band.

91. The shared use of the band by terrestrial and satellite services poses two distinct problems. First, the broadcast satellite transmissions can interfere with the reception of terrestrial signals. In general, this would be a problem for any terrestrial service, but it could be more of a problem for MDS than for ITFS users because of the receiving antennas used. ITFS receiver sites generally are equipped with higher gain and hence more directional antennas than MDS receiver sites. The latter in many cases use low gain less directional antennas that are much more likely to pick up interfering signals from satellites than are the higher gain ITFS antennas. The Corporation for Public Broadcasting submitted an extensive analysis of the impact of sharing this band between terrestrial and satellite users that indicated that terrestrial ITFS users could co-exist with satellite users. CPB was unwilling to extend this analysis to include MDS because of the antenna differences. Comments of the Corporation for Public Broadcasting, supra., at 31, 32.

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92. Terrestrial transmissions in the shared band can interfere with the reception of the satellite signal by nearby earth stations. Here also CPB claimed that the sharing of the band between ITFS and the satellite service was possible but it was again unwilling to extend its analysis to the MDS sharing. CPB claimed that the studies that it presented for ITFS sharing were not valid for MDS because MDS uses omnidirectional antennas and higher power whereas many ITFS stations use directional antennas and lower power transmitters. Id. The argument is that terrestrial transmitters of whatever kind create "holes" where no frequency sharing satellite receive stations can be located and that MDS transmitting stations create larger "holes" than ITFS. We agree. However, others have argued that the creation of such holes should not be used as a justification for precluding terrestrial operation in the same band. The Public Service Satellite Consortium (PSSC) commented as follows:

> "PSSC respectfully urges that limiting the development of 2.5 GHz terrestrial distribution, by claiming that it limits potential satellite distribution in the same band, is not sufficiently strong justification for such action. To limit the developmental potential which 2.5 GHz terrestrial distribution service has, by claiming that such terrestrial distribution causes interference 'holes' in potential satellite coverage in the same band, has few merits when the potentials are viewed together. It is true that 'holes' would be made in satellite coverage in the presence of local ITFS (or other uses of the 2500 to 2690 MHz band), and that satellite earth stations in this band would require careful placement or other precautions to avoid being interfered with." But to limit development of terrestrial networks, which have at least an order of magnitude of more program capacity and flexibility, would be unwise. The total variety of potential programs which could be distributed via satellite on these frequencies is relatively small. In contrast, the variety of programming which could be aired terrestrially within the same band, is about five to six programs for each location where terrestrial transmitters can be coordinated. This would represent thousands of program possibilities which could be tailored to local or regional needs.
>
> "Another consideration which should be recognized as a factor in this argument relates to the demographic distribution of potential 'holes' in satellite coverage. If an assumption is made that a local entity wants to receive a satellite-distributed public service or instructional program, and can point its antenna to one of five or six satellites to receive it, it could do it. But if the program content did not match its needs for programming, either generally or at that particular time, it would probably choose from alternative sources. This is where the demographic distribution enters in. The more densely a city or region is populated, the more likely it will be that diverse programs are available to the public, and therefore less likely that a small selection of nationally distributed material will be useful. Where the satellite-distributed material will be most useful is in the more rural areas of the country where alternatives are not as plentiful.
>
> "Carrying the argument further, rural areas are not as likely to have as great economic justification for installing ITFS transmitters as the more populated regions would have. In rural areas, low-cost satellite receivers installed to serve small towns, and having local signal distribution via low-power VHF or UHF transmitters, would seem to fit the need best. Terrestrial distribution at 2.5 GHz band frequencies would not be justifiable for individual users who would have to invest in additional receiving equipment to get the programs. Simplistically then, there would be no interference 'holes' in satellite beam coverage, where such coverage is most appropriate – in areas where terrestrial distribution at these frequencies is less appropriate and economical."

Comments of the Public Service Satellite Consortium, General Docket 80-113, at 8-10 (Sept. 2, 1980) incorporated by reference in Comments of the Public Service Satellite Consortium, General Docket 80-112, at 4 (September 2, 1980). Perhaps more important in this regard is the fact that we are not aware of any existing plans to construct a public service satellite using this band. Many of those that used the ATS-6 satellite that operated in this band are now leasing transponders from existing satellite communications providers that operate in a different band.

93. The National Aeronautics and Space Administration (NASA) has indicated that it is exploring the use of this band to provide what it terms "feeder links" to provide communications between a "satellite and fixed earth stations, to facilitate interconnection of a mobile satellite service with the terrestrial telephone network." Further Comments of the National Aeronautics and Space Administration, General Dockets 80-112 and 80-113, at 2, 3 (July 2, 1982). NASA is proposing to use the 806-890 MHz band to communicate between a mobile user and a satellite and to use the feeder link to communicate from the satellite back to the feeder link earth station. This would allow for the extension of mobile telephone service to users beyond the range of planned terrestrial networks. NASA has proposed to use the 2500-2535 MHz for the space to earth segment and the 2655-2690 MHz band for the earth to space segment of the feeder links. NASA's proposal is not an allowed use under the existing table allocation and thus would require a separate rule making proceeding before it could be implemented. 27/ In light of its plan, NASA suggests that any additional use of the 2500-2690 MHz by terrestrial users would make sharing of the band by satellite users more difficult.

94. Reallocating specific groups of ITFS channels for MDS would mitigate the problems pointed out by CPB and NASA and would move in the direction suggested by PSSC. Allocating a specific set of channels for MDS use would mean that any future public service satellite use of this band could be structured to avoid sharing the MDS frequencies. Thus, the analysis presented by CPB would be valid in most of the band. Further, the use of the frequencies NASA proposed for its feeder links could also be avoided. Of course, proceeding in this manner will increase the use of the channels that remain available to ITFS but if the CPB analysis is correct, and ITFS use of these is much less inimical to sharing of the band than is MDS use, sharing can still be accommodated.

95. Grandfathering all existing licensees and permittees of and applicants for the reallocated channels accounts for regional variations in ITFS channel use without extensive Commission involvement or analysis. It does not require any existing ITFS licensees, permittees or applicants to alter planned or present use of their authorizations. Where the channels are not being used multichannel MDS applicants have immediate access to the channels, 28/ and where the channels are licensed or applied for MDS operations cannot commence without negotiations with affected ITFS entities.

96. The final element of the plan we are adopting – not accepting any ITFS applications for the reallocated spectrum after adoption of this order – is necessary in order to keep the reallocated channels available for multichannel MDS and to avoid having mutually exclusive, fundamentally different applicants for the same channel. In most cases, the would-be ITFS applicants will be able to be accommodated in the 20 channels that will continue to be available for ITFS.

97. On the basis of this analysis, we have concluded this plan strikes a reasonable balance between the need to continue to make spectrum available for traditional ITFS users and, at the same time, makes spectrum available for multichannel MDS. It does so by minimizing the disruption to the plans of existing ITFS licensees, permittees, or applicants. It is easy to administer and provides at least the possibility of multichannel MDS on a nationwide basis. It also preserves, to the greatest extent possible, the future satellite use of this band.

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27/ On November 29, 1982 NASA filed a Petition for Rule Making in which it formally proposed, inter alia, that this band be made available for this purpose.

28/ It could be argued that if the reallocated channels were the only channels not used in a particular area, and if an applicant were just about to file for these channels, such an applicant would be left with nowhere to apply. We believe that such occurrences will be rare and when they do occur it may be possible to reuse some of the 20 channels that will continue to be available for ITFS use to satisfy the needs of the would-be applicant. Furthermore, in regard to frequency reuse, we have recently been furnished data that indicate there is extensive frequency reuse in several of the large metropolitan areas where ITFS use is heavy. For example, in New York 19 of the 27 authorized channels are reused at least once; in Los Angeles 24 of the 28 authorized channels are reused at least once; in San Francisco 10 of the 26 authorized channels are reused at least once; and in Boston 14 of the 26 authorized channels are reused at least once. "Letter from Victor E. Ferrall, Jr.," General Docket Nos. 80-112 and 80-113, attachment titled "ITFS Channel Utilization in the Top 25 Markets," (May 4, 1983). The letter and the data attached thereto are hereby accepted as informal comments in this proceeding.

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98. We now address the question of how many channels to reallocate for multichannel MDS. This question really involves three separate questions. First, how many channels constitute a viable multichannel MDS system? Second, how many multichannel systems should be provided for in each market? Third, how many channels should be kept in reserve for ITFS use?

99. The existing MDS rules do not allow MDS licensees to operate even a two channel system. Specifically, §21.901(d), 47 CFR §21.901(d), precludes an existing licensee from applying for at least one year and even then it must show that there is a public demand for additional service that is unlikely to be satisfied by a competing carrier. The new rules proposed in the Notice did not contain this restriction. However, the proposed repeal of the section was not discussed in the Notice and we did not receive much comment on it in the first set of comments filed in this proceeding. Virtually all the MDS entities that filed reply comments in response to the Microband Proposal strongly supported the concept of multichannel MDS. Microband itself also noted that the existing restrictions "for all practical purpose, limit carriers to a single channel in any one market," because "it is virtually impossible for MDS carriers to prove a negative – that no other carrier is likely to provide service." Microband Proposal, supra at 38, and 39, n. 48. In its filing, Contemporary Communications Corporation (CCC) argued strongly for multiple channel MDS. CCC claimed that:

> "For both technical and economic reasons, the public would be better served by a single entity operating multiple channels, as opposed to many operators, each limited to one channel. Studies have shown that if multiple channels are to be provided to subscribers, careful control must be exercised over the transmitting parameters of the channels. In particular, for best operation, transmitting locations should be the same. Even better operation will result if common transmitting antennas are used. To achieve satisfactory reception, relative frequencies of the several transmitters must be controlled with respect to one another, to a degree much finer than that required for a single channel. Power levels must also be related among the several transmitters, transmission lines, and transmitting antennas if interference is to be reduced. In sum, only a single operator can insure efficient operation of a multiple channel system.
>
> "In addition to technical operating factors, economic factors also support common ownership of multiple channels. Common transmission line (often costing as much as $25 per foot) and common antennas, costing thousands of dollars, can be utilized for multiple channels if there is only one operator. Rent can be reduced, since only one antenna would be employed, and multiple equipment can be operated in the same room, thereby decreasing the total floor space, as compared to a multiplicity of rooms that might be required for multiple operators. Common maintenance personnel can also reduce the maintenance cost per channel. Further, the number of spare parts needed by a single operator of multiple channels is obviously less than the number required by separate operators each operating one channel. Even electricity costs will be less for multiple channel operations."

Additional Comments of CCC, supra at 7-8.

100. Of course, it is possible to have multichannel MDS systems where each of the channels is licensed to a different carrier. As mentioned earlier, this is the situation in Phoenix where Microband and Contemporary are the carriers and both have the same customer, American Cable Television, offering two-tier programming with the two channels. We believe that for technical reasons, this is probably the only way a two-channel operation will be achieved under the existing rules. Allocating a single channel to each licensee has done little to promote diversity of ownership, and has the significant detriments of increased system complexity, cost, and regulatory delays in providing service to the public. The increased complexity and costs result from the factors listed by CCC in its comments. In a service where the licensee is not permitted to exercise program control the benefits of diversity are less pronounced then they might be where the licensee controls the material transmitted. Although diversity may lead to competition in such things as quality of service, allocating a single channel to each carrier means that there will likely be a comparative hearing for each channel as compared to a single hearing for a multiple channel application. For these reasons, we have concluded that there is no reason to continue to limit MDS carriers to a single channel operation and that the public interest would be better served by the repeal of the single channel limitation contained in §21.901(d) of the rules.

101. Given that multichannel MDS operation will benefit the public interest, we must address the question of how many channels should be in each system. In its proposal Microband suggested that a five channel system was optimum. It based this conclusion on an analysis that showed that "four channels of Pay TV will satisfy 85% of consumer demand." It thus concluded a multichannel system should consist of "four video channels plus a data channel." Microband Proposal, supra, at 48. Another commenter, Tekkom, suggested that 10 channels per system would be in the public interest. Comments of Tekkom, Inc., General Dockets 80-112 and 80-113, 11 (June 28, 1982). CBS, on the other hand, argued that the demand in each market should determine the number of channels in multichannel systems. CBS Comments on the Microband Proposal for Multichannel MDS Service, General Dockets 80-112 and 80-113, at 10 (July 1, 1982). We agree with CBS's claim that there may be regional variations in the number of channels that would be optimum in a multichannel system. On the other hand, we recognize that we are making this reallocation from a band that is divided into four channel groups and that four channel systems would, therefore, be less disruptive of the existing scheme. Also the Microband analysis suggested that 4 channels would satisfy nearly all the consumer demand for premium channels. Furthermore, the fact that MDS is a common carrier service means that market forces will still play a part in determining how users acquire the channels and offer services to the public. Depending on the particular market conditions, a licensee may find it desirable, in a system of carrier initiated tariffs, to offer channels in a variety of different ways. See, e.g., Metrock Corporation, 73 FCC 2d 802 (1979). This variety would reflect the particular needs and desire of users in different areas. Not only may the terms of the offering of channels vary, but also the uses to which they are put may vary. For example, although it appears the channels will at least initially be used for the distribution of premium televison programming, our rules permit "any kind of communications service consistent with the Commission's rules. . . ." 47 CFR §21.903. For these reasons, we have concluded that authorizing 4 channel MDS systems serves the public interest.

102. We also recognize that it is possible that the same entity could lease all of the capacity of each common carrier, thereby precluding others from becoming MDS programmers. Since the public only deals with the customers of the common carrier – and not the common carrier itself – the public could be forced to deal with a single multichannel MDS provider. We have considered requiring multichannel MDS licensees to so tariff their service that such an eventuality could not occur. We have decided not to adopt such a requirement for several reasons. First, we believe that the fact that an entity desiring to lease all available MDS channels will be required to deal with two common carriers somewhat reduces the possibility this will occur. Furthermore, since we are also by this order allowing ITFS licensees to lease excess capacity in their facilities, it is possible that an entity that wishes to provide premium television service to the public could do so using such excess capacity. It is also possible that in many areas, the public will be offered a choice between multichannel MDS and cable. Finally, we believe that restricting MDS tariffs would prevent market forces from determining the optimum mix of channels. Adopting such a requirement would create an artificial upper limit on the maximum number of channels a single entity could program.

103. Finally, we must address the related questions of how many channels to reallocate for MDS and how many channels to hold in reserve for future growth in ITFS. What we must do here is balance the need to make a reasonable number of multichannel MDS systems available with the need to ensure that an adequate number of channels are available for future ITFS growth.

104. In its proposal, Microband suggested that we reallocate three full ITFS groups or twelve channels for MDS use. Microband Proposal, supra, at 33. Microband claims to have based this suggestion on its analysis of the potential number of customers for multichannel MDS service in the top 50 markets. Microband did not submit any analysis to support its suggestion. It did present data on the number of potential multichannel MDS customers in the top 50 market but it did not relate this data to the number of competitive MDS systems that would be optimum or even reasonable. The data presented show that on the average, there are 1,770,800 potential multichannel MDS subscribers in the top 5 markets and 70,400 in markets 46 through 50. Microband took these figures and divided each by 18,000, the break even number of subscribers for a multichannel system, to produce what it called a coverage ratio. What this figure purports to represent is the number of systems that could reach a financial break even point if all the potential customers were to subscribe to a single service and if each of the competing services were to have an equal share of the available customers. The coverage ratio for the top 5 markets was 98.4 and the coverage ratio for markets 46-50 was 3.9. All that the Microband data really show is that there are potential customers for multichannel MDS systems. We believe that there

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are factors other than the number of homes not passed by cable that will determine the number of multichannel MDS systems that can profitably serve an area. These include the nature and quality of the programming available, the quality of signal that can be delivered, the availability of competitive services, the price of the service, and the discretionary income of the residents of the area. These factors may combine in one area in such a way that only one MDS system can be profitable and in another area in such a way that 3 or more systems could be profitable.

105. Consideration of all these factors does not lead to clear choice for the number of multichannel systems that should be authorized in each area. However, it does appear that in many large areas at least two systems could be viable. Moreover, authorization of more than one system should provide a number of public interest benefits. Competition between competing systems could stimulate technological innovation, could increase system availability and could also make lower cost service available to the public. We also believe that we should continue to hold a substantial amount of spectrum in reserve for ITFS use. For these reasons, we have concluded that we should make two groups of ITFS channels available for multichannel MDS. This will allow two competitive MDS operators to offer multichannel service in those areas and will keep 20 channels in reserve for existing and future ITFS use. 29/

106. Another issue to be resolved is what channels to reallocate. In its proposal, Microband suggested that the E, F and G groups be reallocated for MDS use. It based this recommendation on its conclusion that these were the bands least used by ITFS licensees. We do not agree. Our records show that the distribution of ITFS licenses among groups is as follows: A group-225, B group-93, C group-128, D group-82, E group-112, F group-91, and G group-113. Thus, it would appear that except for the A-B group, use of the interleaved ITFS frequency groups is about the same. It should also be noted that the A, C and E groups are significantly more used than the groups with which they are interleaved. This is to be expected because the use of channels in one pair of an interleaved group tends to preclude use of the other group in the same area. Because the interleaved ITFS group use does not vary significantly by group except for the A-B group, we must look to other criteria to select the group to assign to MDS.

107. The most important factor in selecting the groups to be reallocated is minimum interference to the remaining ITFS licensees. This means that we should reallocate an interleaved pair of groups. Proceeding in this manner will result in only two ITFS channels being adjacent to MDS channels. Choosing non-interleaved groups could result in there being as many as 9 ITFS channels adjacent to MDS channels. We also believe that we should avoid reallocating either the group of channels that share the band (2500-2535 MHz and 2665-2690 MHz) that NASA is proposing to use for its feeder link operation so as not to jeopardize consideration of that proposal. This eliminates the A-B pair and G group. This reduces the choice to either the C-D pair or the E-F pair. We also believe that it would be useful to leave the widest possible contiguous band available for ITFS because this would result in the largest possible contiguous bandwidth being left available for shared use by ITFS and Public Service satellite use. This means that if there is a public service satellite use of this band, it would be shared with only ITFS over the largest possible contiguous band. For these reasons, we have concluded that the best pair of channels to reallocate for MDS are the E and F groups.

108. Finally, we must address the question of how to divide the eight channels in the E and F groups between the two MDS operators licensed. We could follow the ITFS assignment method discussed above and assign the 4 channel E group to one licensee and the 4 channel F group to the other licensee. Proceeding in this manner has the advantage of allowing the use of simpler transmitters and downconversion equipment, but it has the disadvantage that widespread adjacent channel interference could occur if the transmitters of the two operators were not colocated. We could also authorize each operator to use 4 adjacent channels; that is assign Channels $E_1$, $F_1$, $E_2$, $F_2$, to one operator and Channels $E_3$, $F_3$, $E_4$, $F_4$ to the other operator. Thus, there would only be one pair of adjacent Channels $F_2$ and $E_3$. Of course with either method, Channel $E_1$ will be adjacent to ITFS Channel $D_4$ and Channel $F_4$ will be adjacent to ITFS Channel $G_1$, both of which may be in use in the area where the MDS channels are being authorized. Thus, by licensing adjacent channels to the same operator, we would be leaving

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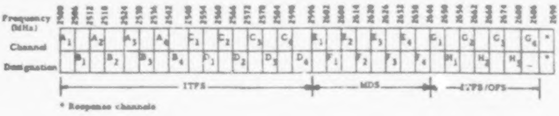
29/ Each applicant will only be allowed to file a single multi-channel application in each service area.

the possibility of adjacent channel interference with existing ITFS stations unchanged and would be eliminating most of the non-colocated adjacent operation from the reallocated spectrum. This could require that the multichannel operators use more complicated transmission and reception equipment.

109. We did not address this issue extensively in the companion Notice, and, although we did not receive much comment on it in response to the companion Notice, some of those commenting on the Microband proposal did address the issue. One commenter, the Microwave Communications Association (MCA), noted that because we did not specifically propose rules for multichannel operation, we would be required to do so in the future. MCA further expressed the view that "this is fortuitous, because it will permit the Commission to consider multichannel systems' operating experience. Actual operating experience is clearly preferable to a lengthy technical rule making based only upon theoretical calculations." Comments of MCA, supra, at 9. There is some validity to MCA's claim; however, we cannot reallocate spectrum without specifying what channels are available for each applicant. 30/ For this reason, we have concluded that the best course to follow is to have each applicant apply for a four channel MDS authorization using the interleaved channel plan now used by ITFS licensees. We also will require each applicant to include, as part of its application, an analysis of the potential for adjacent channel interfere with a non-colocated licensee operating on the interleaved channel group. If the two successful applicants determine either before or after initiation of service that there would be less adjacent channel interference by operating on adjacent channels, we will allow such operation. We believe that the two licensees in each area will be in a better position to make the final determination as to which channelization scheme is best.

110. To summarize, we conclude that it is in the public interest to reallocate 8 of the channels now allocated for ITFS for use by the MDS nationally. Existing ITFS licensees (as well as existing permittees and applicants that eventually become licensees) of the reallocated channels would be grandfathered in perpetuity. Further, we have concluded that reallocating the E and F groups for MDS use would be least disruptive of the existing and potential uses of the 2500-2690 MHz band. We will accept applications for multichannel MDS in all areas of the country regardless of whether the reallocated channels have been previously applied for by an ITFS applicant. In those situations where there is an existing ITFS licensee, permittee, or applicant we shall issue multichannel MDS construction permits conditioned on the permittee obtaining, prior to commencing construction, a statement from each adjacent channel and cochannel ITFS licensee, permittee, or applicant whose transmitter is located within 50 miles of the proposed MDS transmitter site, that the operation of the MDS facility will not cause harmful interference to the ITFS operation or if it does the ITFS operator will accept the interference. We expect that the MDS permittees and the ITFS users of the reallocated channels will negotiate in good faith to mutually accommodate each others' communications requrements. We believe that this process will be beneficial to all concerned. The MDS permittees will be able to offer a potentially profitable new communications service to the public. Existing ITFS users of the reallocated spectrum may end up with better and more efficient communication facilities at no expense, will most likely benefit from technical expertise of the commercial users of the band and will likely benefit from the decreased costs of equipment that will result from the partial commercial exploitation of the band. Finally, the public will benefit from the more efficient use of a valuable national resource, the electromagnetic spectrum. We recognize that there may some large cities in which no reallocation will occur despite the steps we take today. It is likely in those areas in which this plan does not make multichannel MDS available there will be alternative means available by which the public will be able to obtain multichannel MDS including leasing the excess capacity of existing ITFS channels. The following chart illustrates the channel plan we are adopting.



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30/ We will apply existing technical rules to multichannel MDS. We expect to adopt new technical rules for MDS prior to or shortly after the authorization of the first multichannel MDS station. (See Note 1, supra.)

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D. Time Sharing and Leasing

111. In the Notice, we invited comments on the "technical and practical feasibility" of permitting ITFS stations to share unused transmission time with MDS users. We stated that because most educational use occurs during daytime hours while entertainment television occurs in the evening, sharing appeared to be practical. Three forms of sharing were discussed: separate station facilities sharing the same frequency, jointly licensed facilities, and lease of unused transmission time by ITFS licensees. We also asked whether sharing ought to be mandated. Notice, supra, at para. 51.

112. Several ITFS entities accepted our invitation and submitted comments on time sharing of the ITFS channels. Most of the comments received were not favorable. For example, the Joint Council on Educational Telecommunications commented that colleges, universities and hospitals use their channels in evening hours and on weekends, and that entertainment programming often is transmitted on a 24-hour basis. Comment of the Joint Council on Educational Telecommunications, General Docket 80-112, at 5-6 (September 29, 1980). The National Education Association (NEA) reiterated the concerns of JCET and added that sharing is not feasible for other reasons. For example, it stated that ITFS systems are configured to reach designated educational sites while MDS systems that are used to transmit pay television are configured to reach the greatest population possible. Comments of the National Education Association, General Docket 80-112, at 6-7 (September 25, 1980).

113. Several others raised anothr reason why time-sharing is not feasible. In its comments, the Archdiocese of Los Angeles made the following observations:

> " 'Education has for its object the formation of character.' Under the second and third Commission sharing schemes, ITFS licensees would lose control over the content of certain transmissions from their facilities. Much of the programming being broadcast today via MDS is considered by many people to be objectionable – even, at times, pornographic. Proposals for construction of new ITFS facilities, and continued funding of present stations, will likely meet strong opposition from university regents, local boards of education, private institutions and concerned parent-teacher groups if they are placed in the position of having to purvey material which they consider disconsonant with their responsibilities as educators. Thus, these sharing schemes could discourage further ITFS growth – and perhaps result in a reduction of the present number of stations.
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> "Indeed, the Los Angeles Archdiocese is totally opposed to imposition of either of the latter sharing schemes. The Archdiocese would be forced into a difficult moral decision if it faced the prospect of its facilities being used for the transmission of programming which it considered offensive to Catholic values. If the Archdiocese lacked the ability to discriminate as to users of its facilities, it might well have to decide to give up its station altogether so as to avoid becoming party to transmissions contrary to the mission of the Church."

Comment of the Archdioceses of Los Angeles, General Docket 80-112, at 14-15 (September 26, 1980) (footnote omitted) (quoting Herbert Spencer, Social Statistics, pt. 1 ch. 2 (1851)).

114. We agree with the majority of commenters who oppose any requirement that ITFS licensees share or lease their excess channel capacity. Contrary to the belief of those commenters, however, we believe that it ~~is in~~ the public interest to permit ITFS licensees to lease their excess channel capacity. The decision to lease excess capacity thus remains entirely up to the individual ITFS licensee. As a result of the current decrease in federal funding for ITFS, we believe it is appropriate to modify our rules to permit ITFS operators to generate revenues by using their excess capacity for a variety of non-ITFS purposes. 31/ As the excess capacity of ITFS operators is put to use serving the public, greater use of the available spectrum should result. 32/

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31/ The Public Broadcasting Amendments Act of 1981 (Public Law (97-35) Section f(a)).

32/ The Commisson today is also adopting a Notice of Proposed Rule Making that would further assist ITFS licensees in their operations. See Amendment of Part 74 of the Commission's Rules and Regulations in regard to the Instructional Televison Fixed Service, FCC 83-244, (adopted) May 26, 1983 .

115. We think that the changes that we are making today are appropriate for two basic reasons. First, the cost of constructing and operating an ITFS system represents a significant burden to licensees. In addition, the cost of education is increasing daily. ITFS provides a low-cost alternative to specialized instruction, adult education and other instructional modes. However, new revenue sources are necessary in order to give ITFS every chance to grow and succeed. Second, increased interest has been generated in the ITFS band including demand for broader use of the spectrum.

116. Thus, substantial benefits to the public may be derived from allowing ITFS licensees to use excess channel capacity, either by directly utilizing it themselves or through leasing it to others. The income derived from such service could enable stations to be on the air for a greater portion of the day and to increase programming availability. In addition, new revenues might prove sufficient to bring currently vacant channels on the air.

117. Increased revenue would widen ITFS' base of support and contribute to the service's ability to withstand a diminution in any one source of funding without being forced to significantly reduce its overall service to the community. If federal government funding declines, the success of licensees in recouping at least part of the loss may be crucial to ITFS growth and development. The option licensees have to lease excess ITFS channel capacity is consistent with several recent actions taken by the Commission. The Commission amended Part 74 of its rules to permit the shared use of broadcast auxiliary facilities with other broadcast and non-broadcast entities. 33/ It also recently has authorized non-broadcast uses of non-main channel operations, such as teletext and FM subcarriers. 34/ We are adopting policies in this proceeding for leased uses of ITFS excess channel capacity that are consistent with the decisions in the Part 74, teletext and FM subcarrier rule proceedings.

118. Therefore, we are amending Part 74 to permit use of facilities by ITFS licensees for non-ITFS purposes. This authorization includes use of the ITFS station's main broadcast channel and the use of non-main channel excess capacity including subcarriers and the vertical blanking interval (VBI). Furthermore, licensees are permitted to make this excess capacity available to others, if they so choose, on a profit-making basis. We will not, at this time, adopt specific time limitations on non-ITFS use of licensee excess channel capacity. By declining to specify any such limitations, we hope to maximize the spectrum efficiencies that shared use will provide. This will also afford ITFS licensees flexibility in offering their excess capacity to other entities. However, we do expect ITFS licensees to utilize each of their ITFS main channels substantially for legitimate ITFS use. Since we cannot anticipate in advance how much time is required for each licensee to address its ITFS needs, we do not wish to force ITFS channels to remain idle when other legitimate demands for the channels exist. Such an outcome is precisely the situation that we are attempting to avoid by allowing shared use of the channels. This policy is consistent with action taken by the Commission in amendment of Part 74, Subpart F of the Commission's rules to permit shared use of broadcast auxiliary facilities with other broadcast and non-broadcast entities, 48 FR 17081 (published April 21, 1983). As in the proceedings discussed above, if ITFS licensees do make excess capacity available, the question arises as to whether the licensee is engaging in common carrier activity. After briefly explaining the legal requirements under which we must decide the common carriage issue, we shall apply those requirements to the two types of excess capacity at issue, in turn, below.

119. In National Association of Regulatory Utility Commissioners v. FCC, 525 F2d 630 [35 RR 2d 1484] (DC Cir.), cert. denied 425 US 992 (1976) (NARUC I), the court specifically stated that a carrier will not be a common carrier where its practice is to make individualized decisions, in particular cases, whether and on what terms to deal. 525 F2d at 641. The court continued, moreover, that the distinction between common and private carriers was not based on the services offered or the clientele served, but rather on "the manner and terms by which

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33/ 48 FR 17081 (April 21, 1983).

34/ See Amendment of Parts 2, 73 and 76 of the Commission's Rules to Authorize the Transmission of Teletext by TV Stations, Report and Order in BC Docket No. 81-741 [53 RR 2d 1309], adopted March 24, 1983; and Amendments of Parts 2 and 73 of the Commission's Rules Concerning the Use of Subsidiary Communications Authorizations, Report and Order in BC Docket No. 82-536 [53 RR 2d 1519], adopted April 7, 1983.

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they approach and deal with their customers." Id. at 642. The court then stated that in determining whether a particular carrier should be accorded common carrier status, a finding must be made as to whether any legal compulsion to serve indifferently exists, or whether there are reasons implicit in the nature of the operation to expect an indifferent holding out.

120. With respect to leasing of the main ITFS channel, we see no reason to require ITFS licensees who engage in such leasing to be common carriers. One purpose of this proceeding is to make unused channels in the 2500-2690 MHz band available for use on a common carrier basis. We are reallocating channels from ITFS to MDS to serve this purpose, and we believe experience with the reallocation is necessary before we take an additional step and find the need for common carrier channels is so great that all excess capacity should be offered on that basis. Moreover, the requirements of Title II may well discourage or inhibit ITFS licensees from making spare capacity available, if they could only do so as common carriers. For these reasons, we will not require that spare capacity on the main channel be leased on a common carrier basis.

121. With respect to the second test for classifying common carriers, whether there are reasons implicit in the nature of the operation to expect an indifferent holding out, we believe that main channel leasing should not, at least initially, be considered a common carrier activity. Our reasoning closely parallels the decision recently adopted in BC Docket No. 81-794, in which we stated that the selling of excess capacity on television broadcast auxiliary stations would not be treated as common carriage. Shared Use of Broadcast Auxiliary Facilities, 48 FR 17081 [53 RR 2d 1101] (April 21, 1983). We believe ITFS will not engage in a generalized holding out of their excess capacity, but instead will carefully select lessees for long-term contracts. The comments demonstrate that licensed facilities do not readily lend themselves to widespread MDS use. They have been tailored to the particular requirements of the licensee, and, if they do lend themselves to use by another, careful coordination will be necessary. The licensee also must consider its own growth requirements, and likely will limit the availability of the excess capacity so it will be able to use the facilities for its own primary purpose when the need arises. Individual contractual arrangements would better serve this purpose than would a general offer to deal with the public indiscriminately. This individualized selection of clients due to the need to protect the licensee's own use of the facilities was one factor, thought by the court in NARUC I to be inconsistent with common carrier status. 525 F2d at 642. We find nothing inherent in the potential leasing activities of ITFS licensees that would lead them to make indifferent offerings of excess capacity on the main channel. Accordingly, we do not believe that ITFS licensees will act as common carriers. 35/

122. We recongize that permitting ITFS licensees to lease their main channels for other than traditional ITFS purposes may effectively result in a diminution of the channels reserved for traditional purposes, but we believe this risk is acceptable. First, only excess capacity may be leased. We presume the channels were obtained, and are primarily utilized for, satisfying a legitimate ITFS requirement. Because these requirements appear to be increasing in a number of areas, we presume the traditional uses will continue. Second, the pleadings indicate, if anything, a reluctance on the part of licensees to engage in any form of sharing. Finally, any wholesale abandonment of the primary purpose of the facility could jeopardize the entity's license.

123. Just as we find ITFS main channel sharing analogous to our recent Broadcast Auxiliary proceeding, 48 FR 17081 (April 21, 1983), we believe that the regulatory status of subcarrier and VBI leasing can be resolved in essentially the same manner as in the recently adopted FM-SCA and Teletext decisions.

124. Depending on the nature of the information disseminated via an ITFS station's subcarriers or VBI, the regulatory status accorded the service may vary. As noted in the FM-SCA Report and Order, the provision of "broadcast-related services on subchannels is well established and does not raise any new issues of appropriate regulation." Thus, so long as the services provided over the station's subcarriers or BVI are broadcast related, no extraordinary regulatory treatment will attach to the profit-making activity.

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35/ If our initial analysis if incorrect, and ITFS licensees do in fact begin offering main channel excess capacity on an indifferent basis, it would be incumbent on the Commission to determine the extent to which traditional Title II regulation should be applied. See NARUC I at 644; Shared Use of Auxiliary Broadcast Facilities at para. 26.

125. However, other subchannel or BVI uses may be similar to services being provided by licensees in the private radio or common carrier services. To the extent that services offered via ITFS facilities are private radio or common carrier services, these ITFS-delivered services will be treated in the same manner, and with all the same benefits, obligations and responsibilities as the providers of similar services. Thus, with regard to non-broadcast related uses of the ITFS station's subcarriers and VBI, it will be necessary to determine whether the service offered constitutes private or common carriage under NARUC I and applicable statutes.

126. With one exception, the determination as to whether a particular non-broadcast service offered on an ITFS subchannel or VBI is private or common carriage will be made in accordance with the guidance given in NARUC I, as discussed above. Essentially, if the ITFS operator indiscriminately offers the station's subcarriers and VBI to other users, the operator will be regarded as a common carrier and will be treated accordingly. If, on the other hand, the licensee does not engage in an indiscriminate holding out, common carrier obligations will not attach and private carriage rules will apply. The one exception to utilizing the NARUC I test involves land mobile services.

127. With regard to land mobile services, the Communications Amendments Act of 1982, Section 120, establishes a demarcation between private and common carrier land mobile services, and indicates that the test contained in the new Section 331 (c) of the Communications Act is intended to supersede the NARUC I standard. Public Law No. 97-259, 96 Stat 1087. We believe that the test in the new legislation would apply to some of the communications services that could be offered on ITFS subchannels or the VBI. The Act defines a "Mobile Service" as . . . a radio communication service carried on between mobile stations or receivers and land stations, . . ., and includes both one-way and two-way radio communication services." Public Law 97-259 at Section 120(b)(2), 96 Stat 1097, 47 USC §153(n). It is clear that potential ITFS subchannel and VBI services such as paging would therefore be governed by the new legislation, and such services will be judged by the test in the new Section 331(c). The new statutory test is based on the manner in which a multiple licensed or shared private land station is interconnected with a telephone exchange or interexchange service or facility. 36/ See also H.R. Rep. No. 765, 97th Congress, 2nd Session, pp. 52-56 (1082). 37/ The statute also makes it clear that if it is a private system, it is exempt from state and local regulation. 47 USC §331(c)(3).

128. Once an ITFS licensee has determined whether the proposed service is private or common carriage, either under the NARUC I standard or, for land mobile services, Section 331(c) of the Act, the licensee, in order to provide a common carrier service, must seek the appropriate authorization from the FCC. 38/ The ITFS licensee will be in the same position, entitled to the same privileges and subject to the same obligations and regulations as a traditional offerer of common carrier services. 39/

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36/ New Section 331(c)(1) of the Act provides, in pertinent part, that "private land mobile service shall include service provided by specialized mobile radio, multiple licensed radio dispatch systems, and all other radio dispatch systems, regardless of whether such service is provided indiscriminately to eligible users on a commercial basis, except that a land station licensed in such service to multiple licensees or otherwise shared by authorized users (other than a nonprofit, cooperative station) shall not be interconnected with a telephone exchange or interexchange service or facility for any purpose, except to the extent that (A) each user obtains such interconnection directly from a duly authorized carrier; or (B) licensees jointly obtain such interconnection directly from a duly-authorized carrier."

37/ The Commission's interpretation of the test in the new legislation will be fully explored in our reconsideration of the Second Report and Order, Docket No. 20846, 89 FCC 2d 741 [51 RR 2d 313] (April 8, 1982), and our treatment of land mobile services herein is expressly subject to the outcome of that proceeding.

38/ These authorization and filing requirements are illustrated in greater detail in the FM-SCA Report and Order at paragraphs 25-27.

39/ In all cases, involving either private or common carrier services, the applicant will not be seeking approval for the technical facilities of the ITFS station. The Commission regards ITFS subcarrier and VBI use as a secondary privilege that runs with the primary ITFS station license. That right is conferred on the primary station licensee only. In this

[Footnote continued on following page]

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129. ITFS licensees seeking to provide private carrier service on an ITFS subchannel or BVI must notify the Licensing Division of the Private Radio Bureau at Gettysburg, Pennsylvania, 17325, by letter, prior to initiating service. In the letter, they must certify that their facilities will be used in this regard only for permissible purposes. See 47 CFR Parts 90 and 94. When providing land mobile service, they must also certify that service will be offered only to users eligible under Part 90 of the Commission's rules, and that any interconnection of the station with a telephone exchange or interexchange service or facility will be obtained in accordance with new Section 331 of the Communications Act, supra. Such notifications will not give rise to a comment period, and no separate authorization will be issued by the Commission. As in the case of common carrier services, the ITFS operator offering a private service will be in the same position, entitled to the same privileges and subject to the same obligations and regulations as a traditional offerer of such services.

## E. Selection Procedures

130. Several of the commenters in this proceeding expressed the view that if the Commission decided to reallocate spectrum to the MDS, it should simultaneously act to ensure that the application processing procedure will not unduly delay the offering of multichannel MDS service to the public. The Ad Hoc Committee for Wireless Cable outlined the perceived problem as follows:

> "Our primary concern in this regard is that the Commission might adopt a procedure involving comparative hearings for all of the allocated frequencies. It is inevitable that this will lead to interminable delays in conflict with the public interest. Recent Commission experience has established that a certain 'gold-rush' mentality has accompanied reallocation of frequencies. The reallocation of frequencies to the Low Power Television Service spawned thousands of applicants and swamped the processing mechanism. Even the recently allocated spectrum for the Digital Electronic Message and Cellular Radio Service have been sought by more applicants than can be licensed.
>
> "Moreover, many of the applications would probably not meet minimum qualifications necessary to operate a multi-channel MDS system. The development, construction, operation and maintenance of multi-channel MDS systems will require substantial and sophisticated experience in construction and operation of microwave facilities. The time and effort needed to evaluate the qualifications of potential applicants and then compare these applicants would delay the introduction of the service indefinitely, thereby eliminating the prompt introduction of new and innovative programming and the competition such an introduction would bring. Moreover, it would place substantial burdens on Commission resources and personnel."

Ad Hoc Committee Comments, supra at 5-6 (footnotes omitted). The National Association of MDS Service Companies (NAMSCO), the trade organization for users of licensed MDS facilities, expressed the view that "without a concurrently established procedure for processing new MDS applications, the benefits of the long awaited action in this proceeding will be rendered academic." Comments of the National Association of MDS Service Companies, General Dockets 80-112 and 80-113, at 5 (July 2, 1982).

131. In its proposal Microband suggested that these problems could be avoided if the Commission were to "[expand] the capacity of existing MDS Channel 1 and Channel 2 in the top 50 markets by separate allocation." Microband Proposal, supra, at 87. In particular, what Microband proposed was that we reallocate three ITFS channel groups to the MDS and that we allow only existing MDS Channel 1 licensees, permittees and applicants to apply for one of the reallocated groups for 1 year after the date of the order. A second reallocated channel group would be similarly reserved for Channel 2 applicants, permittees and licensees. The third group would

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39/ [Footnote continued from preceding page]

regard, it should be noted that an ITFS licensee that elects to use a subchannel for private or common carriage remains an ITFS licensee for all other purposes. Only the use of the subchannel for non-broadcast related purposes would be regulated in accordance with private radio or common carrier regulation.

be available to any applicant that met the requirements of §21.900 of the rules, 47 CFR §21.900. Id. Appendix F at 3. Thus, what Microband proposed is that two channel groups be made available for existing MDS licensees, permittees, and applicants and that another channel group be made available for all other applicants.

132. In support of its plan, Microband claimed "that the Commission has routinely established separate frequency allocations where the need for the new service was immediate." Comments of Microband Corporation of America, General Dockets 80-112 and 80-113, at 9 (July 2, 1982) (hereinafter cited as 2nd Microband Comments). In Cellular Communications Systems, the most recent Commission decision cited by Microband to support this proposition, we did state that "the Commission in the past has routinely established separate wireline and non-wireline frequency allocations" Cellular Communications Systems, 86 FCC 2d 469, 492 [49 RR 2d 809] (1981), on recon., 89 FCC 2d 58 [50 RR 2d 1673] (1982) (emphasis added) (hereinafter Cellular Order and Cellular Order on Reconsideration). In the Cellular Order, we reviewed the line of cases now relied upon by Microband and concluded that there is:

> "[a] firm legal foundation for establishing a separate wireline allocation in a situation where, . . . (1) there is an immediate need for service to the public, (2) this need can be addressed quickly by a wireline company's expertise, (3) the separate allocation licensing scheme is a reasonable means of avoiding long delays in the availability of any cellular service attributable to comparative hearings, and (4) we have taken reasonable steps to guard against anticompetitive practices."

Cellular Order, supra, at 493 (emphasis added). Before applying these tests to the present situation, we first note that, in the past, we have only authorized separate allocations for wireline carriers in various mobile communications services. Wireline carriers and non-wireline carriers were two distinct classes of applicants for the services. There are not two distinct classes of MDS carriers. For this reason, we believe that Microband's reliance on our policy of making separate frequency allocations for wireline and non-wireline carriers providers of the same service to support its plan is misplaced.

133. Disregarding this fundamental distinction, we nevertheless apply the tests articulated in the Cellular Order to the Microband plan. First, is there an immediate need for service to the public? Microband and other MDS licensees and their customers have argued that there is an unmet public demand for a multichannel premium television service that multichannel MDS will satisfy. We do not believe that this demand is analogous to the verified congestion that existed on two-way mobile systems prompting our separate allocation decision for the Cellular Service. Id. at 489. Rather, we believe what really is at issue here is the timing of multichannel MDS entry into the pay television market relative to the growth curve of cable television and other competitive services. As Microband itself noted, "the primary market for multiple channel MDS will shrink at a rate of ten to fifteen percent per year of delay due to increased cable penetration alone." Second Microband Comments, supra, at 12. What Microband is telling us is that while there is now a need for multichannel MDS, the need may decrease with the passage of time. Thus, we believe it is reasonable to conclude that there is a demand for the delivery of multichannel premium programming that multichannel MDS would be well-suited to provide; however, the need for the service does not justify the separate allocation suggested.

134. Next, do existing licensees and permittees possess some special technical expertise in operating multichannel MDS systems? It is not clear that operating a single channel system gives a licensee multichannel expertise. Even assuming that Microband and other single channel licensees have some technical expertise in operating multiple channel systems as a result of their experience with single channel systems, we do not see how those entities that have only filed applications can be said to have any expertise at all. It could be argued that the only entities with any real experience in operating multiple channel video systems are cable television operators. Thus, we conclude that the Microband separate allocation proposal would not bring a significant special technical expertise to the multichannel MDS service. In reaching this conclusion, we are comparing the technical expertise of those that the Microband plan would favor with the expertise that wireline carriers had in cellular and related technology. The applicants that the Microband proposal would favor do not have equivalent expertise in multichannel MDS.

135. Third, would the separate allocation be a reasonable means to avoid long delays in making multichannel MDS available and, fourth, would it adequately guard against anticompetitive practices? We are considering these two criteria together because we believe

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that one of the fundamental elements of reasonableness is competitive effect. The Microband separate allocation scheme reasonably could be expected to result in the early availability of multichannel MDS service. The Microwave Communications Association, an industry trade organization of MDS carriers, MDS users, equipment manufacturers and others, analyzed the results of the Microband plan as follows:

> "Microband owns 26 Channel 1 MDS stations outright and partially owns an additional 9 Channel 1 MDS stations in which it has management responsibilities, or a total of 35 MDS stations - 70% of the top 50 markets. Further, Microband is a Channel 2 applicant in an additional 13 markets. Thus Microband potentially could have multiple channel ownership interests in 48 out of the top 50 markets. Even more significantly, since most of the Channel 2 markets are mutually exclusive with more than one applicant (there are only three Channel 2 licensees), Microband (or a Microband related company) would be the sole multichannel licensee in 64% of the top 50 markets until the mutually exclusive Channel 2 markets . . . were resolved."

Comments of the Microwave Communications Association, General Dockets 80-113, at 10 (July 2, 1982).

136. American Home Theatre, the MDS customer in Salt Lake City termed the Microband scheme "flagrantly anti-competitive" and concluded that what Microband was seeking was "a substantial 'leg-up' on the provision of Multichannel MDS service while new entrants to the market place would still be tied up in litigation in comparative hearings before the Commission." Comments of American Home Threatre, Inc. With Respect to Proposal of Microband Corporation of America, General Docket 80-112 and 80-113, at 7 (June 2, 1982). On the other hand, Microband claims that if its plan were to be adopted, it would own only twenty-two percent of the 150 multichannel licenses and that this would result in a decrease in its percentage of ownership. Second Microband Comments, supra, at 8-9. Of course, because we are only authorizing two multichannel operations, rather than the three Microband proposed, Microband would have 33% of the licenses. We believe the quoted Microwave Communications Association analysis presents a more realistic view of the ownership statistics that would result if the Microband proposal were adopted. We have concluded that the adoption of the Microband separate allocation proposal would unnecessarily and unreasonably concentrate control of multiple channel MDS systems in a few entities including Microband, and that it would also give such entities a substantial head start in the provision of multichannel MDS service in most markets. Moreover, we believe that other means are available to make multichannel MDS available expeditiously, and we therefore conclude that the advantages of the Microband proposal are outweighed by its detriments. 40/

137. Having reached this conclusion, we must now decide whether to adopt any special procedure for dealing with the expected large number of applications for the newly allocated channels. If we do nothing, the comparative hearing procedures of Part 21 of our rules will apply. As discussed above, many of those filing comments in this proceeding expressed the view that proceeding in this manner would embroil the applicants in lengthy comparative hearing procedures and thereby unnecessarily delay availability of the service to the public. Before discussing other procedures that could circumvent the problems caused by the comparative procedures, we feel that it is useful to consider Microband's view of the existing Part 21 procedures. In its proposal, Microband stated:

> "This MX situation has been with the industry almost since its inception. Unlike some other segments of the communications industry, however, a solution to this problem has been found: merger of competing applications. In nine years, only four MX situations have actually been decided by resorting to comparative hearings. Microband believes that the joint venture solution, which has worked well to date, will continue to solve the MX problem with a minimum of expense to the applicants and to the Commission."

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40/ We recognize that our decision to authorize multichannel MDS could impact upon other services. However, there is no evidence in the record before us that would support protecting existing entities from competition and we expect the public overall to benefit from these authorizations.

Microband proposal, supra, Appendix A, at 1, n. 1. Thus, Microband seems to contend that we should adopt a new procedure to avoid the problems of our comparative hearing procedures, and in the same proposal, tells us that our comparative procedures have worked rather well. This position is not necessarily inconsistent. The comparative hearing procedure can work well where there are only two or three entities applying for the same frequency. If there are 5, 10, or more mutually exclusive applicants for the same frequency, the comparative procedures work less well. In the first place, it is much less likely that 10 mutually exclusive applicants will reach an agreement to form a joint venture than if there are only two or three mutually exclusive applicants. Furthermore, in those situations in which it is necessary to hold a hearing among a large number of mutually exclusive applicants, it is likely that several of the applicants will be equally well qualified and thereby force us to make a choice on the basis of very minor differences in the applicants. For these reasons, we conclude that the comparative hearing procedure may not be the best method to resolve mutually exclusive multichannel MDS applications.

138. Some of those that predicted we would receive a large number of mutually exclusive applications if we authorized multichannel MDS suggested that we use a lottery procedure to grant multichannel MDS authorizations. For example, Contemporary Communications Corporation suggested that, "In the current pro-competitive deregulatory environment, we believe the only fair method of selecting licensees is by lottery among applicants meeting threshold qualifications determined by the Commission." Additional Comments of CCC, supra, at 10.

139. Section 309(i) of the Communications Act authorizes us to grant licenses or permits "through the use of a system of random selection." 47 USC §309(i)(1). On March 31, 1983, we adopted the Second Report and Order in General Docket 81-768 in which we provided specific rules to implement a lottery scheme. In adopting the Order, we noted that Congress intended that we use a lottery where it would best serve the public interest and that we should consider the following factors in determining whether a lottery would be in the public interest: whether there are a large number of available licenses; whether there are a large number of mutually exclusive applications for each license; whether there is a significant backlog of applications; whether the lottery would significantly speed up the process of getting the service to the public; and whether diversity of information sources would be enhanced. Using these factors, we initially determined that 5 services are amenable to the use of random selection techniques. The services were low power television, private land mobile radio, private operational fixed microwave, aviation and marine services, and domestic public land mobile.

140. The new legislation also directs us to use notice and comment rule making procedures each time we intend to use a lottery in a specific service. 47 USC §309(i)(4)(A). Many of the commenters in this proceeding predicted that we would receive a large number of applications if we made spectrum available for multichannel MDS. We agree that this is a likely result. We are therefore proposing to use a lottery to select all MDS permittees, both multichannel and single channel, in a separate Further Notice of Proposed Rule Making in this Docket.

141. In regard to using random selection procedures for MDS, we note that we had previously proposed several alternative methods for selecting from among mutually exclusive MDS applicants. 41/ One of the methods proposed was a lottery. The other two methods proposed were an auction and a paper hearing. The Lottery Notice was primarily concerned with the question of our legal authority to employ alternatives to comparative hearings to resolve mutually exclusive situations. Since the new legislation specifically authorizes us to use a random selection procedure and provides Congressional guidance on when the expedited procedure should be used, there is no reason to consider further the selection procedure proposals contained in the Lottery Notice.

142. The only other issue raised in that proceeding concerned trafficking rules. In the Lottery Notice, we suggested that, if we were to adopt a lottery procedure, it would also be appropriate to eliminate or modify the existing anti-trafficking rules now applicable to MDS.

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41/ In the Matter of Amendment of Part 21 of the Commission's rules to Permit the Use of Alternative procedures in Choosing Applicants for Radio Authorizations in the Multipoint Distribution Service, Notice of Inquiry and Proposed Rule Making, CC Docket No. 80-116, 45 FR 29,335 (May 2, 1980) (hereinafter Lottery Notice).

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Lottery Notice, supra, para. 74 and Appendix A. In Appendix A, we pointed out that the anti-trafficking provisions contained in §§21.27 and 21.39 of the Rules, 47 CFR §§21.27, 21.39, are mandated by Section 310 of the Communications Act, 47 USC §310. We further noted that §21.40 of the Rules, 47 CFR §21.40, was not required by the Act. This section gives us discretion to inquire whether a facility that has been operated less than 2 years by the proposed assignor or transferor had been acquired for the purpose of profitable sale rather than public service.

143. We recently considered the question of the continued usefulness of the anti-trafficking rules and policies with reference to broadcast licensees. In the Matter of Amendment of §73.3597 of the Commission's Rules (Applications for Voluntary Assignments or Transfers of Control), Report and Order, BC Docket No. 81-887, FCC 82-519 [52 RR 2d 1081] (released December 2, 1982) (hereinafter Trafficking Order). There we eliminated what was known as the "three year rule." That rule, which was similar to §21.40, required that we designate for hearing all applications for transfer or assignment of broadcast station licenses that had not been held for three years. Id. at para. 1. After reviewing the reasons for the rule and its effect during its 20 years of existence, we concluded that it was:

> "appropriate to eliminate our . . . 'trafficking policy' and to limit Commission action in this area to enforcing the requirements of Sections 301 and 304 of the Communications Act. Such Commission inquiry will be restricted to whether any party has engaged in activity indicating action contrary to the statutory prohibition on license sales, such as attempting to profit on the transfer of a bare license. The Commission will continue to exercise its statutory authority under the Communications Act to determine that each transfer it approves is in the public interest."

Id; at para. 29. We also concluded that because Sections 301 and 304 state that radio station licenses do not convey a property interest, "profiting on the transfer of a construction permit is contrary to the letter and spirit [of these sections]." Id. at para. 32. Finally, we concluded that we should treat licensees that had obtained their license in a comparative hearing differently than other licensees. In particular, we held that a one year holding period after starting operation should be imposed on permits obtained through comparative hearings. Id. at para. 35.

144. Because the Part 21 common carrier trafficking rules stem from the broadcast policy, we have concluded there is no reason to continue to apply these rules to common carriers where we are no longer applying them to broadcast licensees. Therefore, for reasons analogous to those relied upon in the Trafficking Order, we have decided to eliminate those portions of §21.40 that limit the free transferability of Part 21 licenses.42/ We shall retain those portions of §21.40 that limit the transferability of construction permits and we shall add new language to §21.40 to limit the transferability of station licenses that were obtained through comparative hearings. This action is independent of whether we ultimately decide to use a lottery for multichannel MDS. The new §21.40 is included in Appendix B.

145. Finally, we recognize that, although it is our belief that elimination of the trafficking rules will in general result in the more efficient use of the spectrum in that the ultimate licensee will be the entity that values it most highly, it is possible that situations could occur in which the licensee's best interest would be in not using the spectrum. For example, it is possible that a cable television company that had been awarded a cable franchise for a particular area but had not yet constructed its system would find it in its best interest to purchase the multichannel MDS license and not use the station, thereby preventing the establishment of MDS service in the area. This would preserve the largest possible customer base for the cable company. Because this is common carrier service, the licensee is required to render service on a reasonable basis in accordance with the obligations imposed by Title II of the Act. For this reason, we believe we have adequate regulatory tools to deal with this problem should it occur.

146. We have now resolved the only unresolved issue raised in the Lottery Notice. We are, therefore, terminating that proceeding. Comments relating to the use of a lottery in multichannel MDS should be filed in Docket 80-112.

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42/ Section 22.40 of the rules is equivalent to §21.40. In common carrier Docket 80-57, we are considering the revision and updating of Part 22. We will consider equivalent changes to §22.40 in that proceeding.

## F. Application Procedures

147. One of our primary concerns in making this reallocation is to ensure that no existing ITFS operation experiences unacceptable degradation in service as a result of the operation of a multichannel MDS station. For this reason, we are adding a new subsection to the rules requiring that multichannel MDS permittees demonstrate that they will not cause any harmful interference to any ITFS receiver site located within 50 miles of the proposed MDS transmitter location. 47 CFR §21.902(d).

148. We have tried to anticipate other eventualities that could unduly delay the introduction of multichannel service to the public. One such eventuality, commonly referred to as "grid-lock," could be caused by the combination of a large number of applications and the operation of §21.31(c) of the rules, 47 CFR §21.31(c). Grid-lock refers to the situation in which applications proposing to serve widely separated geographical areas are mutually exclusive. For example, if two metropolitan areas, A and B, were separated by 75 miles and several applications were filed for each area, it is unlikely that any of the applications proposing to serve area A would be mutually exclusive with those proposing to serve area B. If, however, even one application was filed that proposed to serve the area located midway between area A and area B, it is likely that it would be mutually exclusive with all the applications proposing to serve area A and all the applications proposing to serve B. This means that all of the applications proposing to serve area A would be in a sense mutually exclusive with those proposing to serve area B. If another area C were located 75 miles from either A or B, a similar set of circumstances could result in all the applications filed for area C being mutually exclusive with those filed for both area A and area B and the connecting areas. It is not difficult to envision a set of circumstances in which an application that proposed to serve a location in Maine would be mutually exclusive with an application proposing to serve a location in Florida.

149. We have considered several methods to avoid this result. One of these was to enforce rigorously §21.902(a) of the rules, 47 CFR §21.902(a), that requires all applicants to make "exceptional efforts" to avoid blocking cochannel use in nearby cities. We do not believe that this rule alone is enough to avoid the problem. For this reason, we have decided to limit the applications that will be considered to be mutually exclusive for purposes of inclusion in either a comparative hearing or a lottery — if we should decide to use such a selection procedure in this service — to those applicants that propose to locate their transmitters within a given Standard Metropolitan Statistical Area (SMSA) or within 15 miles of the boundary of the SMSA (if the transmitter is not located in another SMSA) or that propose to serve the SMSA. In those situations where the SMSA to be served is a part of a Standard Consolidated Statistical Area (SCSA), it will be considered with all other applications proposing to serve the SCSA. 43/ We are requiring applicants proposing to serve any portion of an SMSA to specify what SMSA it intends to serve. In those situations where SMSAs that are not part of SCSAs are either adjacent or so close that a single transmitter could produce a signal strong enough to cause harmful interference in both SMSAs, we require that each applicant not only specify which SMSA it intends to serve but also to detail what steps it will take to prevent blocking cochannel use in the adjacent SMSA. Issues of mutual exclusivity for applications not proposing to serve SMSAs will be resolved using only existing Part 21 Rules. However, we do require all such applicants to specify the name of the primary service area. Each applicant will only be allowed to file a single application for each service area.

150. We believe that by using techniques such as cross-polarization and frequency offsets that it will be possible to avoid cochannel interference in most situations. We stress again that we expect applicants to address this problem in their applications. Those applications that do not contain an analysis of how the applicant intends to avoid cochannel interference in adjacent areas will not be considered acceptable for filing.

151. We expect existing ITFS licensees to cooperate with would be MDS applicants to make channels available. We believe that cooperation between MDS providers and ITFS licensees could result in benefits to each. The ITFS licensees could benefit from the technical expertise of MDS operators and the MDS operators would benefit from access to the ITFS spectrum. Most importantly, the public will benefit from more intensive use of the spectrum.

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43/ We intend to use the list of SMSAs and SCSAs to be published by the Office of Management and Budget on June 30, 1983 as our source for SMSA definitions in this service.

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152. All MDS applications must contain a statement that the applicant will comply with the following interference protection requirements:

> (1) With respect to the ITFS, the MDS operator must attempt to obtain the written consent of all licensees, permittees and applicants of cochannel and adjacent channel ITFS transmitters located within 50 miles of the MDS transmitter prior to commencing MDS construction facilities.
>
> (2) With respect to cochannel and adjacent channel MDS operations, the MDS applicant must provide the level of interference protection proposed in Docket 80-113 until a resolution of that proceeding has occurred.
>
> (3) To assist us in enforcing §21.902(a) of our rules, that requires applicants to make "exceptional efforts" to avoid blocking cochannel use in nearby cities and adjacent channel use in the same city, the applicant must explain what efforts it has made to comply with this section.

Applicants will be granted construction permits conditioned on their submitting to the Commission, prior to commencing construction, a statement from all cochannel and adjacent channel ITFS licensees, permittees or applicants that have transmitter sites within 50 miles of the proposed MDS transmitter that the operation of the multichannel MDS facility will not cause harmful interference to their ITFS operations or if it does that the ITFS operator will accept such interference. If the applicant is not able, after making reasonable efforts, to obtain such a statement it may in the alternative submit evidence that the operation of the proposed MDS would not cause harmful interference to the existing ITFS operations. 44/

153. Finally, as noted above (see para. 88, supra) we do not believe it would be in the public interest to require the first group of applicants for the reallocated channels to submit the interference analysis required by §21.902(c)(1) of our rules, 47 CFR §21.902(c)(1). For this reason, we are hereby waiving the requirement that the first group of applicants for the reallocated channels comply with §21.902(c)(1). If we subsequently decide to accept a second group of applications for these channels (see para. 154, infra) such applications must contain the interference analysis required by §21.902(c)(1).

154. Because it is possible that two new MDS construction permits will be granted simultaneously in some markets, and because it is possible that MDS or ITFS operations in markets that are in close proximity may present potential interference problems, it will be difficult for applicants to comply fully with §21.902(a). We will therefore allow MDS construction permit holders to apply for modifications to their facilities in order to minimize interference potential with other MDS and ITFS operations.

155. Section 21.43 of our rules, 47 CFR §21.43, requires construction of an MDS facility within eight months of grant, athough construction permit holders may request extensions. We believe that it is appropriate to grant extensions liberally to MDS construction permit holders in the E and F groups. The reason for this is that, particularly in major markets, many of the E and F channels will be occupied. In this case, the grant of an MDS constuction permit is simply an authorization for the permittee to enter into negotiations with certain ITFS licensees. While the permittee may, subject to the interference protection requirements, commence operations on as few as one channel, the enterprise may not be viable unless a larger block is assembled. Hence, while we will look favorably on requests for time extensions of construction permits, such requests must include information on the permittee's efforts to assemble a viable block of channels and an estimate of the construction timetable.

156. In general, we will use existing Part 21 procedures to process multichannel MDS applications. However, we believe it is necessary to adopt procedures to deal with what we referred to in the Cellular Reconsideration Order as "one-upmanship." There we stated that:

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44/ In this regard it should be noted that lessees of the E or F group channels will not be protected from harmful interference caused by an MDS licensee operating on these channels.

> "We want all participants to file applications which represent their best view of a service plan for the named SMSA. To do so, we do not find it necessary for participants to consult the plans of their potential competitors. Setting up a plan which would allow applicants to revise their filings after viewing the applications of others would encourage applicants to engage in 'one-upmanship,' which has harmful consequences. This would undermine our ability to compare proposals with some measure of confidence that the applicant had participated in its development. Plans based on another proposal would no longer represent the applicants' best idea of how to serve a given area but would, instead, represent applicants' use of the administrative process to obtain an advantage over competitors. Furthermore, allowing opportunity for one-upmanship would needlessly encumber an administrative process which we must streamline to its essentials if the American public is to receive cellular service without unnecessary delay."

Cellular Reconsideration Order, supra, at 89 (footnotes omitted). We recognize that there are significant differences between the technical planning required to operate a cellular communication system and that required to operate a multichannel MDS system. Our experience with both MDS and the more recently authorized Digital Electronic Message Service (DEMS) has taught us that some applicants merely copy applications that have previously been filed and resubmit them with the names changed. We believe that this kind of activity does smack of the "land rush" or "gold rush" mentality that concerned many of the commenters in this proceeding. Our experience with single channel MDS applications is that in many instances a local entity will perceive the need for service in its community and file the appropriate application only to have another entity file a competing application on the final day allowed by our Rules thereby delaying the introduction of service to the public. We do not believe that such activity is in the public interest. We will, therefore, initially only accept multichannel MDS applications on the 45th day after publication of this Order in the Federal Register. 45/ We cited the well-established legal precedent for proceeding in this manner in the Cellular Reconsideration Order and noted that this procedure "treats all prospective applicants equally and fairly by giving them substantial advance notice of due dates for their applications." Id. at 90. After processing the first set of applications, we will determine whether to proceed to accept further applications in this manner or to allow applicants to file using the existing Part 21 cut-off procedures.

### G. Other Matters

157. Several of the commenters in this proceeding questioned the need and wisdom of continuing to regulate MDS as a common carrier service. Michael Benages claimed that:

> "The Commission's rules impose on the MDS licensee its status as a common carrier, but they do not alter the fact that in operation the licensee is functionally equivalent to [a] broadcast licensee, and most specifically, the licensee of a subscription television facility."

Comments on Proposal of Microband Corporation of America, by Michael Benages, General Dockets 80-112 and 80-113, at 7-8 (July 2, 1982). In the same vein Tekkom commented that:

> "Common sense would dictate a current regulatory approach to MDS similar to that adopted for STV. STV is, as a practical matter little different from MDS. In STV, the licensee can either operate the subscription television service or sell the airtime to another under terms of a contract negotiated to meet the marketplace realities. The staff's adherence to a strict interpretation of tariff rules prevents MDS from being allowed to act on a cost efficient basis and, instead, imposes a regulator's view as to what is 'possible, practical and desirable.'"

Comment of Tekkom, Inc., supra, at 4-5. Contrasted to these views is the view expressed by the Ad Hoc Committee for Wireless Cable.

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45/ If the 45th day after release of this Order falls on a holiday, applications should be filed on the next business day. 47 CFR §§1.4(i), (d).

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> "[T]he Commission wisely chose to establish MDS as a common carrier service. By separating the ownership of facilities from decisions over programming, the Commission permitted the risks of this new venture to be spread among different entrepreneurs with differing focuses, interests and abilities. Whereas Carriers gained expertise in system construction and operation, Operators moved into each community and provided the service which they believed was most demanded in that community. The latter invested their resources in trucks, technicians, reception equipment, programming and advertising. They were also unencumbered by the costs of regulatory compliance. This separation of investment risks has maximized the speed with which MDS has grown.
>
> "The existing MDS structure has worked well and has been to the benefit of the public: It should not be changed for the sake of change. . . ."

Comments of the Ad Hoc Committee, supra at 11-12. Because we did not propose to change the regulatory status of MDS in this proceeding, we believe it would be inappropriate for us to act on this issue in this proceeding. Those who believe that this issue should be addressed further are invited to submit a Petition for Rule Making.

158. The National Cable Television Associaton (NCTA) and Warner Amex Cable Communications, Inc. (Warner Amex) filed comments concerning another issue not raised in the Notice. Warner Amex and NCTA point to heavier regulatory burdens faced by cable television systems as compared to those faced by other providers of video services including MDS and conclude that the Commission should act to eliminate these disparities. The NCTA position is that:

> "[I]t is crucially important that the Commission recognize that the new service that Microband proposes would enjoy significant regulatory advantages over cable that would distort competition between the two services. To promote its own objectives of fostering true competition and diversity, the Commission should accompany any authorization of Microband's proposed service with a comprehensive proceeding fashioned to level the playing field on which MDS, cable and the other old and new video services will compete."

Comments of the National Cable Television Association, Inc., General Docket 80-112 and 80-113, at 12 (July 2, 1982). Warner Amex concludes that:

> "Before considering Microband's proposal and the issues in the above-captioned rule making proceedings, the Commission must first address the issue of regulatory parity among competing technologies. To ignore this issue any longer, while at the same time creating additional economic advantages for cable's competitors (via preemption), is unfair to the cable industry, its subscribers and the public interest generally."

Comments, Warner Amex Cable Communications, Inc., General Dockets 80-112 and 80-113, at 6 (July 2, 1982). It may not be possible (assuming it were desirable) to "level the playing field" on which multichannel MDS and cable "play." There are vast technological differences between multichannel MDS and cable that strongly favor cable. Cable systems have the capability of providing more than one hundred channels of television service. The multichannel MDS systems we are authorizing today are limited to four channels. Cable systems have the capability to serve all locations within a service area. Our experience with single channel MDS is that most operators, because of various propagation factors, have difficulty serving more than 50% of the locations within their service areas. Furthermore, the service areas of MDS operators are frequently much smaller than the service areas of cable companies. As far as regulatory burdens are concerned, MDS licensees are subject to the full panoply of Title II common carrier regulation. Cable has never been subject to these obligations. For these reasons, we find little merit to arguments raised by NCTA and Warner Amex as presented. Petitioners may wish to submit a petition for rule making addressing these issues in a substantiated, focused manner.

159. Turner Broadcasting Systems (TBS) urged that we act on its Petition for Rule Making requesting the deletion of the cable television "must-carry" rules. TBS notes that Microband in its proposal claims that multichannel MDS operators will provide the "right mix" of channels on their systems to maximize subscribers and concludes that cable television systems, especially 12 channel systems, are not free to similarly provide the "right mix" of programming to their

customers because of the must-carry rules. TBS's petition is now being studied by the Commission staff. However, we do not believe it would be in the public interest to delay this proceeding pending action on the TBS petition.

160. Finally, on December 21, 1979, Microband filed a Petition for Rule Making, RM-3540, in which it requested that we investigate the feasibility of exchanging the existing MDS Channel 2 allocation (2156-2162 MHz) with a 6 MHz band allocated to some other service. Microband suggested that we consider common carrier frequencies in the 2110-2130 MHz and 2162-2180 MHz bands or operational fixed frequencies in the 2130-2150 MHz, 2180-2200 MHz and 1850-1990 MHz bands. Microband's reason for submitting this petition was its concern that Channel 2 operation would cause unacceptable adjacent channel interference with existing Channel 1 operations. As discussed above, Channel 1 and Channel 2 are now being operated in Phoenix, Arizona and none of the interference problems suggested by Microband have materialized. Furthermore, since we are by this order removing the restriction limiting MDS operators to single channel per service area, we believe that many Channel 2 operators can enter into joint ventures with existing Channel 1 operators and thereby make two channel service available. For these reasons, we have concluded that there is no need to proceed with the rule making suggested by Microband and we will by this Order dismiss its petition.

## IV. Regulatory Flexibility Act

161. The Regulatory Flexibility Act of 1980 does not apply to rules adopted after January 1, 1981 when the underlying notice of proposed rule making was adopted before that date. The underlying Notice of Proposed Rule Making for this proceeding was adopted March 19, 1980. Accordingly, there is no need for certification under the Regulatory Flexibility Act. See 5 USC §601.

## V. Conclusions

162. We believe that we have in this Report and Order arrived at equitable treatment of all concerned parties and at the same time have adopted policies that best serve the public interest. In particular, we believe that the policies and rules set out herein recognize and provide for the unique needs of the existing and potential users of the ITFS channels and also provide would-be providers of multichannel MDS service spectrum to meet anticipated public demand. This proceeding has required that we balance difficult competing interests in reaching a decision which should result in more intensive use of the spectrum while preserving legitimate needs of existing users.

163. Accordingly, it is ordered, pursuant to Sections 4(i) and 303(r) of the Communications Act, 47 USC §§154(i), 303(r), that Title 47 of the Code of Federal Regulations is amended as described in Appendix B. These amendments shall become effective thirty days after publication of this Order in the Federal Register and we will accept multichannel MDS applications only on the forty-fifth day after publication of this Order in the Federal Register.

164. It is further ordered that the Microband Petition for Rule Making RM-3540 is dismissed and that proceeding is terminated.

165. It is further ordered that the proceeding in Common Carrier Docket 80-116 is terminated.

166. It is further ordered, that the portion of the application of Channel View, Inc. requesting authority to conduct a market experiment, File No. 8938-ED-MR-82, is denied.

167. It is further ordered that the developmental applications of Contemporary Communications Corporation to construct and operate multichannel over-the-air pay video service facilities in New York, Chicago, Los Angeles, St. Louis, and Philadelphia, File No. BPEX-820802KH, are denied.

168. It is further ordered that Form 330P is amended as set forth in Appendix C effective upon obtaining approval of the Office of Management and Budget as required by the Paperwork Reduction Act. 44 USC §3502(4).

169. It is further ordered that applications for Channel Groups E and F filed after 12:00 PM, May 26, 1983, must be consistent with the provisions herein.

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## CONCURRING STATEMENT OF
## FCC COMMISSIONER JAMES H. QUELLO

As you know, my consistent position on this issue has been that there is a heavy burden of proof on those who seek to take away frequencies reserved for educational purposes. I am concerned that the Commission is not adequately taking into consideration the educational community's future needs for this spectrum as this nation moves into the information age. Nevertheless, the staff and some of my colleagues do want to make additional channels available for commercial video services. Given that this is inevitable, I believe that this document represents an exceptional balancing of competing interests in a very difficult area. I believe that if reallocation must result, this document appears to be a reasonable approach which maintains priority where it belongs — with educational entities.

I have been reluctantly persuaded to concur in this document because of the following provisions and assurances:

(1) all existing ITFS applicants, permittees, and licensees have been "grandfathered";

(2) at least 20 channels are reserved exclusively for ITFS;

(3) educators will be permitted for the first time to lease excess capacity so as to provide the potential for needed additional revenues;

(4) MDS applicants will receive only a conditional construction permit and must get an agreement in writing from the existing ITFS licensee before they can begin construction on the same channel or an adjacent channel;

(5) MDS applicants must protect ITFS operators against interference.

Finally, I must note that the Commission, in making its decision had to give some weight to the lack of existing use of the ITFS spectrum. It is a significant argument that in a substantial number of states there are no channels in use and no applications on file.

While we cannot ignore the loss of potential for ITFS service resulting from this action, I strongly hope that the educational community will recognize the significant benefits which will accrue to the ITFS service as a result of this decision. We must all now look to the future and allot the highest priority to applying the ITFS service as an innovative tool for making our nation more productive and our people better able to cope with a rapidly changing world.

## CONCURRING STATEMENT OF COMMISSIONER MIMI WEYFORTH DAWSON

I concur in the "reallocation" of certain ITFS channels for multi-channel MDS use, but I do so with a number of reservations. In particular, while I agree with the allocation of spectrum for multi-channel use, I think the Commission could have accomplished this in a way which is both less intrusive to ITFS operators and at the same time better insures the viability of the multi-channel service which the Commission purports to create.

As to the effect on ITFS, for example, I do not understand the necessity for the creation of two four-channel MDS systems rather than one system. This Commission has often spoken of the proliferation of competition in the video marketplace. With this multitude of services, a single four-channel MDS system would face competition whether or not the Commission authorizes a second four-channel system. And obviously, the authorization of a single four-channel system would have had a substantially lesser impact on existing ITFS users, particularly if the Commission had reallocated the three under-used OFS channels for MDS use rather than dipping into the more heavily used ITFS channels. I wish these options had been seriously explored by the Commission staff.

However, having made the policy choice to "reallocate" enough spectrum for two multi-channel MDS systems, the Commission should have proceeded to make multi-channel MDS as viable as possible. But I am fearful that the Commission's decision fashioned in the name of compromise, does not bode well for the timely creation of multi-channel MDS systems, at least in the major markets. And if it appears that the Commission has so burdened multi-channel

MDS that it stands little chance of getting off the ground, then I believe that the Commission should reevaluate its allocation of ITFS spectrum to MDS.

The burdens on potential MDS operators in this oddly configured "reallocation" are numerous. For example, even the "winners" of MDS lotteries 1/ win only the right to negotiate with co- and adjacent channel ITFS licensees within a 50-mile radius of the MDS stations. 2/ In fact, MDS permittees, before they may begin construction, must submit a statement from those co- and adjacent channel ITFS users to the effect that "the operation of the multi-channel MDS station will not interfere with the ITFS operation or that the ITFS operator would accept any interference that did occur." 3/ Obviously this gives current ITFS operators something in the nature of a veto power over MDS systems with the only bright spot in such a procedure being that the veto must be related to "harmful interference" to existing stations. 4/ Thus, at least it would appear inappropriate under the negotiation process adopted by the Commission for an ITFS operator to veto MDS systems simply because the ITFS operator does not agree with the programming proposed to be presented on the MDS system or for any reason other than a reasonable belief that the MDS system will interfere with the ITFS operator's existing facilities. 5/

In short, while I agree with the allocation of spectrum for multi-channel MDS operation, I hope that the Commission has not pre-ordained laggard construction and fitful performance by the multi-channel systems; if the Commission has done so, then the disruption to existing ITFS users will have occurred for no reason. 6/

## STATEMENT OF COMMISSIONER HENRY M. RIVERA CONCURRING IN PART, DISSENTING IN PART

This Report and Order has two principal aims: to create a new multi-channel video delivery service, and to assure adequate spectrum for future ITFS growth. With respect to these aims,

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1/ The failure of the Commission to adopt lottery procedures now – which I believe the Commission could have done – also adds to the delay in providing multi-channel MDS service. I can only hope that the further notice proposing lottery can be completed expeditiously so that MDS service may be provided to the public in something approaching a timely manner.

2/ Report and Order at para. 85.

3/ Id.

4/ Id. Rather than this clumsy and laborious process, I would have preferred the application of the "last-in" theory familiar both to the Commission and to broadcasters. E.g., Sudbrink Broadcasting of Georgia, Inc., 65 FCC 2d 691, 692 (1977). Under this more familiar procedure MDS systems could have been permitted to construct but would have been required to correct any harmful interference to ITFS operators.

5/ It is also important to emphasize my belief that the Commission's decision grandfathers only "existing" ITFS facilities, i.e., those which have been granted, those which are operating and those which have been applied for. To extend grandfathering to inchoate systems is to invite confusion and to delay even further the provision of multi-channel MDS service. See Report and Order at para. 85.

6/ I must disagree with one small aspect of the Commission's decision. Consistent with the decision in Amendment of §73.3597 of the Commission's rules, ___ FCC 2d ___ (BC Docket 82-887, released December 2, 1982), the instant decision substitutes a "one-year" transferability rule for the "three-year" rule now in force at least for those licenses "that were obtained through comparative hearings." Report and Order at para. 144. While it seems unlikely that this rule will have much effect given the proposed application of lotteries to choose MDS permittees, I continue to believe that any such limitation on the free transferability of licenses "is wholly antithetical to the deregulatory philosophy of this Commission." Amendment of §73.3597 of the Commission's rules, ___ FCC 2d at ___ (dissenting opinion).

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the decision represents a basically fair balancing of the interests of the affected spectrum users and I concur in most of it. However, the Commission erred in failing to precisely define and limit the degree to which ITFS licensees may lease "excess" capacity and I dissent to that part of the decision. As I have previously indicated, 1/ I am concerned about the potential de facto spectrum reallocation made possible by the Commission's failure to adopt clear guidelines governing excess capacity leasing. If de facto reallocation occurs, one of the aims of this Report and Order – assuring adequate spectrum for future ITFS growth – will be thwarted. In view of the apparently intense outside commercial interest in these microwave frequencies, this issue will be far more than academic, at least in the long term, as ITFS usage multiplies. While I certainly do not wish to deprive ITFS licensees of the new income-producing opportunities extended other licensees, I am concerned that the Commission's laissez-faire approach here will prove detrimental to our ability to manage the spectrum in the future.

I also emphatically dissent to the majority's decision to sidestep the media diversity issues inherent in the new "wireless cable service" provided by multichannel MDS. My fellow commissioners apparently believe that there is no place for such concerns in a common carrier service. I disagree. While MDS is nominally regulated as a common carrier service, the majority should have faced the fact that to the viewer, the wireless cable transmission is indistinguishable from other home video mediums, no matter what their regulatory classification. 2/ To the viewer, it is all "television." Whether we care to acknowledge it or not, MDS transmissions can influence social, cultural, political and moral values to the same extent as conventional broadcast television. Given this reality, the Commission should have explicitly evaluated options to assure that the new multichannel service will optimally further the robust ideological diversity we have worked so long to achieve in broadcasting.

Common carriers, by law, may neither discriminate among those wishing to use their facilities nor exercise control over transmission content. At first blush, these limitations would appear to mitigate many of the concerns underlying structural and behavioral regulation of broadcast licensees, who do control channel access and transmission content. However, the theoretical programming diversity benefits of common carrier regulation are constrained in MDS. As an initial matter, our rules allow an MDS licensee to provide up to fifty percent of its transmission time to an "affiliated subscriber." 3/ Although carriers are prohibited from influencing the content of such transmissions, the efficacy of such a prohibition upon affiliated entities is highly questionable. Where such substantial influence actually is exerted, the diversity-related virtues of common carrier regulation, as well as the classification of MDS as a common carrier, are frontally undermined.

The MDS licensee's apparent freedom to enter long-term contracts with a single customer as to one or more channels in a given local market also substantially curtails, if not eliminates, the diversity-related benefits common carrier regulation might otherwise be expected to provide. In such circumstances, the programmer-customer is functionally indistinguishable from a broadcast licensee. Unlike a broadcaster, however, its discretion over programming is completely unfettered. As a result, the public's exposure to the widest possible diversity of viewpoints may be diminished, despite the fact that authorization of multichannel MDS is intended to promote that goal.

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1/ See Report and Order Authorizing Shared Used of Broadcast Auxiliary Facilities with Other Broadcast and Non-Broadcast Entities, released April 15, 1983 (Docket 81-794) (Concurring Statement of Commissioner Henry M. Rivera).

2/ In point of fact, there is little apparent practical difference between MDS home video service and broadcast subscription television. In both services, a licensee typically leases transmission facilities to program distributors or their surrogates, whose goal is to reach as many members of the public as are willing to pay for the service. Neither service can be employed without special equipment. The STV licensee, unlike the MDS licensee, is entitled to deal with the lessee/programmer of its choice and is legally responsible for transmissions over its facility. However, the soundness of the disparate regulatory classifications applied to MDS and STV is open to question, given that an MDS licensee may lease most or all of its channel capacity to a single lessee. See generally Report and Order paras. 101-102; Metrock Corp., 73 FCC 2d 802 (1979).

3/ See 47 CFR §21.903(b).

In the broadcast arena, the Commission has traditionally held the view that programming diversity can most effectively be maximized by diversity of ownership and control of broadcast outlets. It has therefore placed heavy emphasis upon structural regulatory policies which, among other things, promote diversity of ownership in local markets through one-to-a-market, duopoly and media cross-ownership rules narrowing curbing local media combinations. 4/ The media diversity objective underlying local ownership restrictions in the broadcast service is no less compelling in MDS, which is widely viewed as as alternative to conventional broadcasting, and whose regulatory status and configuration are murky at best. The fact that the FCC has elected to regulate MDS as a common carrier service simply does not negate the reduction in diversity of viewpoint that occurs when an entity obtains the unfettered right to program an MDS channel in a market where that entity already controls another mass communications medium or when a single entity obtains the right to program multiple MDS channels. 5/ The majority has apparently blessed such anti-diversity combinations in MDS, essentially because restrictions "would prevent market forces from determining the optimum mix of channels." See Report and Order paras. 101-102.

For the reasons just outlined, the majority's failure to consider even minimal regulation in furtherance of First Amendment values was a serious mistake. The Commission could have easily provided a small measure of assurance that diversity would be furthered by formulating tariff requirements preventing MDS licensees from leasing channels to entities already owning other media interests in the same geographic market. Furthermore, the Commission could have considered tariff requirements precluding programmers from leasing more than one MDS channel per market. This would have demonstrated at least a minimal commitment to longstanding FCC policies in furtherance of diversity of voices within local markets. The Commission has previously confirmed its authority to reach the activities of a common carrier's programmer-customer through tariff provisions, 6/ and it would not have been difficult to fashion such restrictions for MDS, whose service characteristics are reasonably well established.

The Commission could also have elected to fully explore what alternative or additional diversity-enhancing policies to apply to MDS in the further rule making notice to be issued regarding MDS lotteries. In the final analysis, this more comprehensive approach may well have been preferable. The options to be examined could have included various tariff prescriptions, including but not limited to those described above, a dual licensing scheme for MDS carriers and their programmer-customers, or reclassification of MDS as a broadcast

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4/ Among the other structural broadcast regulatory rules and policies designed to promote programming diversity are those which proscribe regional broadcast ownership concentration, limit the total number of broadcast properties that can be commonly owned, emphasize diversification of ownership in the comparative licensing process, and mandate non-discrimination and affirmative action in broadcast employment. If the Commission had seen fit to examine more broadly the media-related implications of MDS and the policy options available to address those concerns, see infra, it could also have explored the extent to which the foregoing regulation should be applied to MDS.

5/ Some of my colleagues contend that the FCC has never directly regulated programmers and that, therefore, regulation of MDS programmer-customers is legally foreclosed. Their basic operating assumption is incorrect. Cf. Columbia Broadcasting System, Inc. v. FCC, 629 F2d 1, 26 (DC Cir. 1980), aff'd, 453 US 367 (1981) (confirming FCC authority to apply Section 312(a)(7) to the major broadcast networks). However, there is a logical reason why the FCC ordinarily does not regulate programmers per se: its policies directly apply to the entities responsible for program selection and transmission, i.e. broadcast licensees. In any event, the Commission has broad discretion to regulate interstate communications by radio or wire to protect the public interest. See, e.g., 47 USC §§152(a), 154(i), 303(g), 303(r); United States v. Southwestern Cable Co., 392 US 157 (1968). See generally, National Broadcasting Co. v. United States, 319 US 190, 209-21 (1943). In this instance, important policy objectives detailed previously counsel in favor of utilizing this broad discretion to impose diversity-related requirements upon MDS programmer-customers, either directly or indirectly.

6/ See, e.g., Direct Broadcast Satellites, 90 FCC 2d 676, 711 and n. 85 (1982). The Commission declined to impose limited broadcast-type regulation on DBS common carrier

[Footnote continued on following page]

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service. 7/ At the conclusion of that proceeding, if additional regulations were adopted, applicants could have been allowed to amend their applications to conform to these new rules as necessary.

My colleagues have not seen fit to follow either route, apparently out of fear that by doing so, the Commission would be expected to saddle MDS with the panoply of rules that apply to broadcast licensees. Any such fear was largely without foundation. This Commission has shown that it can be very creative in regulating the many communications services within its purview by rejecting outmoded or unnecessary rules while continuing those which further fundamental communications policy. That approach could have been followed here. Instead, the Commission essentially decided to remain blind to the actual service characteristics of MDS and to important policy issues implicit in it. By blinking reality, the FCC has seriously undermined the credibility of its efforts to maximize diversity of ownership and expression. To this highly regrettable, if unexpressed, policy shift, I dissent.

## APPENDIX A

### Comments for General Docket 80-112

Illinois Institute of Technology
Memorial Hospital Medical Center of Long Beach, CA
Interact: Interactive Television Network, Hanover, NH
The American College of Physicians
Spring Branch Independent School District, Houston, TX
Joint Council on Educational Telecommunications
Indiana Higher Education Telecommunications System
San Diego City Fire Department
Association of Hospital Television Networks
Georgia Institute of Technology
Harris Corporation
Farinon Electric Operations
Purdue University
Oklahoma State Regents for Higher Education
Association of American Railroads
Communications Satellite Corporation
KLVX Channel 10, Las Vegas, NV
Connecticut Board of Education
State of MO, Dept. of Elementary and Secondary Education
Office of the Los Angeles County Superintendent of Schools

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6/ [Footnote continued from preceding page]

programmers because the service is novel and still in the developmental stage. Id. The same cannot fairly be said of MDS, which was created in 1974 and is currently provided in several markets around the nation.

7/ No doubt a variety of options exist – I am not particularly wedded to any one of the foregoing at this juncture.

Northeastern University
Anaheim City School District
Superintendent of Public Instruction State of North Carolina
Board of Education, Chicago, IL
Bert Edwards
Ninth District PTA (California)
University of California, Santa Barbara
Instructional Television Center, Dallas Co. Community College
American Association for Community Junior Colleges' Task Force on the Uses of Mass Media Learning
Advanced Micro Devices Inc.
Colorado State University
Lawrence Liverpore Laboratory
Daytona Beach Community College
Watkins-Johnson Company
The University of Alabama in Birmingham
Vista Unified School District, Vista, CA
Hillsborough County Public Schools
Sperry Univac Computer Systems
The Hospital Council of Western Pennsylvania
University of Colorado
Miami-Dade Community College
Hewlett-Packard Company
El Centro College, Dallas, TX
South Bay Union School District
Systems Control, Inc.
Bakersfield City School District
Satellite Business Systems
National Aeronautics & Space Administration
Intel Corporation
School Board of Pinellas County, FL
American College of Radiology, Chicago, IL
Eastfield College
Richland College
Long Beach Unified School District
San Dieguito Union High School District
Honorable, Senator Harrison Schmitt (NM)
Southern Pacific Communications Company
Ford Aerospace & Communications Corporation
Cherry Electrical Products Corporation
Lakeside Union School District
Indiana Higher Education Telecommunication System
California Media & Library Educators Association
TV College Consortium San Diego & Imperial Counties Community College Association
The School Board of Broward County, FL.
Argonne National Laboratory
The California State University & Colleges
Mark Controls Corporation
San Diego Regional Instructional Television Fixed Service System
San Diego County Superintendent of Schools
Florida Department of Education
Fresno County Department of Education
San Diego Unified School District
Rev. John Geaney, C.S.P. Unda - USA
San Diego Miramar College
South Carolina Educational Television Commission
National Educational Association
Southwestern College
Arizona State University
San Diego & Imperial Counties Community College Association
MiraCosta College
Teleprompter Corporation
National Association of Educational Broadcasters

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National Public Radio
Satellite Syndicated Systems, Inc.
Public Service Satellite Consortium
University of South Florida
California Public Broadcasting Commission
Northstar Communications
Elburn MDS Co.
San Bernardino MDS Co.
Angeles MDS Co.
Microwave Communications Systems, Inc.
The National Association of Public Television Stations
Sylvania Systems Group
Oceanside Unified School District, CA
Board of Regents, The University of Wisconsin System
Dade County Public Schools
Illinois Institute of Technology
Kirkwood Community College
Central Committee on Telecommunications of the American Petroleum Institute
American Library Association
Superintendent of Public Instruction, State of California
A. Ruth Badgett
Homer H. Badgett
Nantucket MDS
Marion County Schools, Ocala, FL
Commonwealth Edison, Trustee of the Illinois Institute of Technology
Massachusetts Department of Education
California Department of Education
School Board of Palm Beach County, FL
Chula Vista City School District, CA
Caterpillar Tractor Co.
Association for Educational Communications & Technology
New Trier Township Television/Film Cooperative
Coronado Unified School District, CA
Cable Television Review Commission County of San Diego, CA
Pasadena Unified School District, CA
Southern California ITFS Advisory Committee
Jules Cohen & Associate
International Harvester
Illinois Institute of Technology
American Association of School Administrators
Ohio Educational Broadcasting Network Commission
Georgia State Board of Education
Schwartz, Woods & Miller
CBS, Inc.
Archdiocese of San Francisco
University of Maryland
National Telecommunications & Information Administration
Joint Council on Educational Telecommunications
National Association of MDS Service Companies, Inc.
Public Interest Satellite Association
Archdiocese of Los Angeles
National Instructional Telecommunications Council, Inc. and Catholic Television Network
U.S. Catholic Conference
The Leland Stanford Junior University
The Volusia County School Board
Motorola, Inc.
Corporation for Public Broadcasting
Center for Excellence, Inc.
Archdiocese of New York
University of California
Grossmont Community College District
University of Minnesota
Aiken Cablevision, Inc.

Colony Communications Corporation
Comcast Corporation
Cox Cable Communications, Inc.
Palmer Communications, Inc.
U.S. Department of Education
The Prism Company
Palomar College
St. Petersburg Junior College
David A. Fountain
University of California, San Francisco
University of Southern California
Illinois Institute of Technology
Jet Propulsion Laboratory
Richardson Independent School District
Huntsville City Schools
National Catholic Educational Association
The Association for Higher Education of North Texas
Office of the Governor of Georgia
Rocky Mountain Corporation for Public Broadcasting
School Board of Dade County, FL
Standard Oil Company of California
Norman M. Jackson
Microband Corporation of America
Centerstage
Humbert Cardinal Medirros, Archbishop of Boston
The Los Angeles Radiological Society
General Dynamics
Glendale District, Los Angeles County Medical Association
KHS78 Instructional TV, Mesquite, TX
(TAGER) The Association for Graduate Education & Research
Concordia College
Texas Wesleyan College
U.S. Catholic Conference
F. Raymond Zintz
Boston Catholic Television Center
Electronics, Missiles and Communications, Inc.
The Association for Higher Education of North Texas
University of Maryland
Catholic Television Network San Francisco
Richardson Instructional Television Center
Instructional Television of the Archdiocese of N.Y.
Corporation for Public Broadcasting
CBS, Inc.
Microband Corporation of America, "Urbanet" Proposal

Responses to Microband's "Urbanet" Proposal

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Bogner Broadcast Equipment Corporation
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National School District, National City, CA
San Dieguito Union School District, CA
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Utilities Telecommunications Council

Central Committee on Telecommunications of the American Petroleum Institute
Teleprompter Corporation
Public Interest Satellite Association
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## APPENDIX C

1. Form 330P, Application for Authority to Construct or Make Changes in an Instructional TV Fixed Station and For Response Station(s) and Low Power Relay Station(s) is amended by adding the following:

. . . . . . .

Describe briefly the primary purpose of the requested authorization.

State the anticipated percentage of time for which the channel will be used by entities other than the licensee.

List the total number of existing authorizations and state the combined percentage of time for which these channels are presently used for transmissions of material for others.

---

FCC 83R-45
4759

| | | |
|---|---|---|
| In re Applications of | ) | |
| GAF BROADCASTING CO., INC. | ) | BC Docket No. 82-371 |
| For Renewal of License of<br>Station WNCN(FM)<br>New York, New York | ) | File No. BRH-810202G7 |
| CLASSICAL RADIO, INC.<br>New York, New York | ) | BC Docket No. 82-372<br>File No. BPH-810501AD |
| For Construction Permit | ) | |

Adopted: June 14, 1983
Released: June 16, 1983

[¶51:223, ¶51:225] Leave to intervene denied.

The administrative law judge's denial of a petition to intervene in an FM renewal proceeding, which was filed by a local listeners' group, is affirmed. The judge did not abuse his discretion in rejecting petitioners' claim that, if permitted to intervene, they could offer significant evidence not necessarily available to any other party concerning pending changes in the licensee's management, the licensee's relations with organized listener groups and the licensee's alleged manipulation of the station's citizens advisory group, nor in concluding that the proffered evidence was irrelevant to any issue designated in the proceeding or was suitable for presentation by non-party witnesses. GAF B/casting Co., Inc., 54 RR 2d 159 [Rev. Bd., 1983].

## ORDER

By the Review Board: (Board Chairman Marino issuing separate statement.)

1. Appellants WNCN Listeners' Guild, Inc. and Classical Radio for Connecticut, Inc. have been attempting to intervene in this proceeding as parties, pursuant to §1.223 of the Commission's rules. 47 CFR §1.223. The presiding Administrative Law Judge (ALJ) initially denied their request and we tentatively affirmed by Memorandum Opinion and Order, FCC 83R-39 [54 RR 2d 94], released May 19, 1983, but permitted appellants additional time to supplement their appeal to demonstrate that they had met the standard of discretionary intervention of §1.223(b) of the rules. Although appellants had not met that standard theretofore, the Board invoked the "spirit" of Office of Communications of the United Church of Christ v. FCC, 350 F2d 994 [7 RR 2d 2001] (DC Cir. 1966), to allow them to show how their intervention would illuminate the issues designated in this case. In a later Order, FCC 83R-42 [54 RR 2d 96 ], released May 25, 1983,

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we instructed that any such supplementation should be filed with the ALJ. We did so because of temporal exigencies 1/ and because "the ALJ who is to conduct that hearing may be in the best position to determine whether any supplemental material submitted would affect his prior determination on intervention." Id., at para. 1. The ALJ considered appellants' supplementation, Classical Radio, Inc.'s supporting comments, and the Mass Media Bureau's opposition and again denied intervention. Order, FCC 83M-1929, released June 13, 1983.

2. We now have before us an emergency appeal filed by appellants on the eve of hearing, in which they request the Board to rule on the basis of the pleadings already submitted to the ALJ. Because of the exigencies of the situation, we will rule ex parte, without waiting for the filing of responsive pleadings. Section 1.45(e), 47 CFR §1.45(e). In the instant appeal appellants assert that, if allowed to intervene as parties, they could offer significant evidence at hearing not necessarily available to any of the other parties concerning three areas: (1) pending changes in GAF management; (2) GAF's relations with "organized" listener groups; (3) GAF's alleged "manipulation" of the station's citizens advisory group. The ALJ reviewed the appellants' outline of proposed evidence and concluded that it is "either irrelevant to any issue designated in this proceeding, or is suitable for presentation by non-party witnesses." FCC 83M-1929, supra. at 2.

3. Having previously declaimed that the ALJ was probably in the "best position" to determine whether appellants' intervention would assist in the trial of the issues, we will not second-guess the ALJ's decision, no error of law being apparent. 2/ If, after hearing, appellants wish to submit an amicus brief to the ALJ or, if any initial decision is appealed to the Board, their views should be welcome. 3/

4. Accordingly, it is ordered, that the appeal from denial of leave to intervene, filed June 13, 1983, by WNCN Listeners' Guild, Inc. and Classical Radio for Connecticut, Inc. is denied.

## SEPARATE STATEMENT OF BOARD CHAIRMAN MARINO

While I join in the Board's Order, it should be noted that the Administrative Law Judge did not rule on the question of whether appellants are entitled to intervene as a matter of right. See American Communications Association v. FCC, 298 F2d 648 [22 RR 2060] (DC Cir. 1967). His action is probably attributable to the fact that many of the allegations on which appellants relied had been previously rejected by the Bureau Chief, whose actions are awaiting Commission review. For us to demand more of the ALJ would exceed our limited authority.

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1/ The hearing was scheduled to commence on June 13, 1983.

2/ Appellants' concerns (2) and (3) relate to an application for review, presently pending before the Commission, on which we cannot comment. See FCC 83R-39, supra. at n. 2.

3/ We again note that §1.225(b) of the rules, 47 CFR §1.225(b), specifically permits participation in hearings by a non-party, who "shall [not] be precluded from giving any relevant, material, and competent testimony at a hearing because he lacks a sufficient interest to justify his intervention as a party in the matter." Thus, from a substantive standpoint, denial of formal intervention rights does not preclude appellants from appearing and presenting relevant evidence here. However, based on what has been shown so far, we agree that granting appellants a formal party status — replete with discovery and subpoena rights as well as cross-examination rights on the issues already designated (on which appellants have shown no interest) — has not been justified. We also note appellants' allegation that the licensee has attempted to "manipulate" its Citizens Advisory Committee, one or more of whose members may testify at hearing. Appellants further allege that two of its members are also members of the Advisory Committee and could testify as to such "manipulation." Supplemental Petition for Leave to Intervene, Exh. A at 3-4. Should members of the Advisory Committee testify, §1.225(b) would accord appellants' two member witnesses the identical right, and we observe that neither the Advisory Committee nor its other members have sought to intervene as separate parties. Whatever the licensee's relations with its Advisory Committee, we see no reason why the matter cannot be injected into the record through witnesses on both sides of the apparent dispute.

EXHIBIT B

# Wireless or Wired Cable: Comparable Technologies?

By George Harter
General Electric
Comband Division

Can the performance of a microwave Multichannel Multipoint Distribution Services (MMDS) meet or exceed cable system performance? The answer is yes. MMDS performance can meet and even exceed cable in fundamental performance areas like received signal level, carrier-to-noise ratio and nonlinear distortion products. Also, MMDS equipment can provide all of the bells and whistles of a cable system like addressability, scrambling and stereo broadcasts. Combining comparable features and improved performance can make MMDS a successful compliment to an existing cable system or a very competitive alternative.

## Performance

To begin, let us define a typical MMDS and cable system as shown in Figure 1. The MMDS system will utilize an omnidirectional transmitting antenna mounted 500 feet above ground level. For simplicity we will assume a constant receive antenna height of 20 feet and a flat earth, realizing the farthest practical receive site distance will be limited to approximately 40 miles by the radio horizon. The detailed characteristics of the transmit and receive site equipment are listed in Table 1.

The cable system design is simple and consists of a series of feedforward trunk amplifiers with a generous 2600' of separation. Each trunk amp breaks off into feeder legs consisting of a bridger amplifier and two line extenders. The performance levels at the output of this second line extender will be compared with the MMDS performance levels at the block downconverter output. The characteristics of each of the amplifiers are listed in Table 2.

Using the systems described above, the C/N was calculated for distances out to 40 miles (80 trunk amplifiers) and is shown in Figure 2. The perturbations in MMDS C/N from .5 to 1.5 miles out is caused by the elevational pattern characteristics of the transmitting antenna. Now, 80 trunk amplifiers may not be practical for cable system operation, but 40 miles of coverage area certainly is practical for MMDS operation. As you can see from Figure 2, the MMDS system C/N with only 10 watts of transmitter output power exceeds the cable system performance out to a distance of approximately 28 miles (57 trunk amplifiers). Increasing the transmitter output power to 20 or 100 watts can potential increase the C/N margin even further.

Figure 2 describes the ideal situation where the C/N is only limited by the signal level received at each receive site. For systems of 2 to 16 channels in size this level of performance is quite practical. However, when the number of channels increases to beyond 16, the downconverter dynamic range will typically limit the maximum allowable received signal level and thus will be the controlling factor for C/N. This is especially true for clear line-of-site receive sites out to distances of 20 to 25 miles from the transmitting antenna.

Likewise, the downconverter dynamic range will usually be the controlling factor for the system nonlinear distortion performance. The architecture of the MMDS transmitting system is optimized for minimum distortion generation. An individual transmitter is used for each channel and channels are combined through the use of passive waveguide combiners. Typical crossmodulation and intermodulation numbers of -60 db are very typical at the output of the transmitting antenna(s). Therefore, the downconverter is the only active element in the system handling the combined power of all channels. Because of this, the downconverter input level must be kept within the specified dynamic range to insure optimum intermodulation and crossmodulation performance (typically -55 to -60 db). This adjustment of received signal level will ultimately affect the C/N ratio.

Cable has a much more severe problem with nonlinear distortions because of the number of active devices handling all of the video channels. Crossmodulation, intermodulation and composite triple beat will worsen through every amplifier. The major contributor to nonlinear distortions in a cable system are the feeder lines containing the bridger amplifiers and line extenders. These amplifiers typically have 20 to 30 db worse distortion figures than the trunk amplifiers. Because our model of a cable system contains only two line extenders and one bridger amplifier per trunk amp, the crossmodulation calculations result in excellent performance for both cable and MMDS. However, unlike MMDS, the potential for distortion products to increase grows as a cable system expands.

## Limitations

As described above, MMDS can have significant performance advantages over cable. However, there are limitations placed on MMDS because it is an over-the-air technology. Because of the frequency of the MMDS transmissions (2.1 to 2.7 GHZ) it is essentially a line-of-site technology. Receive sites with totally or partially obstructed views of the transmitting antenna may have tremendous variations in received signal strength. Receive sites surrounded by foliage may experience large signal level fluctuations as the seasons change. It is essential to insure clear line-of-site between transmit and receive sites in order to obtain consistent performance at all times.

However, these problems with terrain and obstructions can be managed. There are signal strength contour studies available which will predict the amount of loss an MMDS operator can expect from terrain. By combining these studies with intuitive reasoning regarding other structures in the propagation area and foliage, an MMDS operator can predict his coverage area very accurately.

## Other Advantages

Not only can MMDS offer performance advantages over cable, but also increased system reliability. Since there is no closed distribution system, the only equipment concerns are at the transmit site and the subscriber's home. The current design trend for MMDS transmitting equipment is away from tube technology and towards solid state devices. Solid state technology is more reliable and less power consuming.

The receive site antenna and downconverter are designed to reside on the subscriber's roof in a variety of weather conditions with excellent reliability. However, the potential weak link in the receive site installation can be the interconnections from the downconverter to the antenna and into the subscriber's home. Care must be taken to insure all connections are sealed and weather tight. The ingress of moisture into these interconnections can have considerable impact on received signal quality.

Another significant advantage to MMDS is the speed at which a system can be built. Once the construction of the system begins, it is not unusual to be ready to install subscribers 1 to 3 months afterwards. This is significantly better than the typical start-up times for a cable system.

## Bells and Whistles

Currently available MMDS equipment also offers all of the operational features of cable systems and then some. Signal security, addressability, stereo compatibility and spectrum space for ancillary data services are all available in MMDS.

Security wise, both audio and video scrambling techniques are available. Current techniques consist of video inversion, sync suppression, bandwidth compression and combinations of these.

Addressability is performed through the use of in-band data transmission. Current techniques involve transmission in either the video or audio paths. Along with addressability come features like pay-per-view capability, flexible tiering and combining of programming, channel mapping and increased deterrents to pirating of signals and converters.

Since most MMDS equipment is designed to handle the additional audio bandwidth for BTSC stereo, the system is stereo transparent from the beginning. With the addition of stereo encoders at the transmitter site and decoders in the home, subscribers can enjoy excellent quality stereo sound.

## Conclusions

A well designed and well managed MMDS system can exceed cable system performance in the fundamental areas which significantly impact subscriber satisfaction. Through careful and detailed system design, MMDS can achieve an excellent reputation as a high quality and high performance broadcast service. Also, since MMDS operators do not have an expensive distribution system to maintain, more attention can be paid to customer service and satisfaction. However, it is important for an MMDS operator to understand the technical capabilities and limitations of his system. With this understanding, an MMDS operator can build a successful and profitable business.

EXHIBIT C

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7 Boyle Road
Scotia, NY 12302
Wayne E. Wagner, President
(618) 374-6079

Gerald Stevens-Kittner, Esq.
Fleischman & Walsh
1725 N St., N.W.
Washington, DC 20036
(202) 466-6250

## Louisiana

### Shreveport

Capital Cities Entertainment
Systems, Inc.
1330 Avenue of the Americas
34th Floor
New York, NY 10019

Andrea Timko Sillet, Esq.
Wilmer, Cutler & Pickering
2445 M St., N.W.
Washington, DC 20037

## Maine

### Portland

International Broadcast Consultants
8070 Soquel Dr., Suite 260
Aptos, CA 95003
Robert A. Ruark, President
(408) 688-3992

Charles O. Verrill, Jr., Esq.
Patton, Boggs & Blow
2550 M St., N.W.
Washington, DC 20037

## Michigan

### Detroit

George Fritzinger
Group III Management Corp.
419 N. Larchmont Blvd.
Suite 256-A
Los Angeles, CA 90004

Benito Gaguine, Esq.
Flye, Shuebruk, Gaguine,
Boros & Braun
1211 Connecticut Ave., N.W.
Washington, DC 20036
(202) 835-9699

### Ironwood

Superior Communications Systems
James R. Maccani
4140 Elkhorn Drive, N.E.
Cedar Rapids, IA 52401

### Jackson

Booth American Co.
333 W. Fort St.
Detroit, MI 48226

## Minnesota

### Alexandria

Walter Bush
1125 Natham Lane, N.
Suite 317
Plymouth, MN 55441

### Morton

Walter Bush
1125 Natham Lane, N.
Suite 317
Plymouth, MN 55441

**Willmar**

Walter Bush
1125 Natham Lane, N.
Suite 317
Plymouth, MN 55441

**Winthrop**

Todd Communications
6545 Cecilia Circle
Minneapolis, MN 55435

## Mississippi

**Columbus**

Lawrence N. Brandt
Suite 220
3201 New Mexico Ave., N.W.
Washington, DC 20016
(202) 363-1100

Todd D. Gray, Esq.
Dow, Lohnes & Albertson
1255 23rd St., N.W.
Washington, DC 20037
(202) 857-2500

**Hattiesburg**

Microband Corporation of America
655 Third Ave.
New York, NY 10017
Don Franco, President

Stephen R. Bell
Squire, Sanders & Dempsey
1201 Pennsylvania Ave., N.W.
Washington, DC 20004

**Meridian**

Multichannel Distribution of
America, Inc.
2550 South Parker Road
Suite 300
Aurora, CO 80014
Omar A. Duwaik, President
(303) 751-6100

Gerald Stevens-Kittner
Fleischman & Walsh
1725 N. Street, N.W.
Washington, D.C. 20036
(202) 466-6250

## Missouri

### Kansas City

| | |
|---|---|
| Kansas City Southern Industries, Inc.<br>114 W. 11th St.<br>Kansas City, MO 64105<br>Phil Brown, Vice President<br>(913) 384-0401 | Jane Maxwell, Esq.<br>Sullivan & Worcester<br>1025 Connecticut Ave., N.W.<br>Washington, DC 20036<br>(202) 725-8190 |

### Kennett

Chancie L. Pylant
125 Corporate Drive
Hot Springs, AK 71914

### St. Louis

Blue St. Louis Partnership
c/o Du Treil-Rackley
1200 18th St., N.W.
Suite 607
Washington, DC 20036

## Nevada

### Reno

Jonsson Communications
620 Bercut
Sacramento, CA 95814

## New Mexico

### Deming

Telmaster
Box 1763
Deming, NM 88031

**Gallup**

Lawrence N. Brandt
Suite 220
3201 New Mexico Ave., N.W.
Washington, DC 20016
(202) 363-1100

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Washington, DC 20037
(202) 857-2500

## New York

**Elmira**

Private Networks
c/o William Walker,
Tri-Ad Consultants, Ltd.
157 W. 57th St.
New York, NY 10019

Tyrone Brown
Steptoe & Johnson
1330 Connecticut Ave., N.W.
Washington, DC 20036

## North Carolina

**Charlotte**

Cheyenne Corp.
8503 Hollyridge Rd.
Jacksonville, FL 32216

**Hickory**

Microband Corporation of America
655 Third Ave.
New York, NY 10017
Don Franco, President

Stephen R. Bell
Squire, Sanders & Dempsey
1201 Pennsylvania Ave., N.W.
Washington, DC 20004

## North Dakota

**Fargo**

Joseph W. Hubbard
26573 Basswood Ave.
Ranchos Palos Verde, CA 90274

## Ohio

**Cincinnati**

Gencom, Inc.
Three Forest Plaza
12221 Merit Drive, Suite 800
Dallas, TX 75251

Superior Broadcasting Co.
27181 Euclid Ave.
Euclid, OH 44132

**Youngstown**

WKBN Broadcasting Co.
3930 Sunset Blvd.
Youngstown, OH 44501

## Oklahoma

**Oklahoma City**

Hinton Telephone Co.
Box 100
Hinton, OK 73047

## Pennsylvania

**Erie**

Microband Corporation of America
655 Third Ave.
New York, NY 10017
Don Franco, President

Stephen R. Bell
Squire, Sanders & Dempsey
1201 Pennsylvania Ave., N.W.
Washington, DC 20004

**Philadelphia**

Dominion Leasing Corp.
84-14 170 Street
Jamaica, NY 11432

Northwest Communication
7900 Germantown Avenue
Philadelphia, PA 19118

### Pittsburg

Pro Communication
1105 Delaware, 2nd Fl.
Buffalo, NY 14213
Michael J. Specchio, President

James F. Ireland
Cole, Raywid & Braverman
1919 Pennsylvania Ave., N.W.
Washington, DC 20006
(202) 639-9750

## Puerto Rico

### Mayaguez

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3201 New Mexico Ave., N.W.
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Todd D. Gray, Esq.
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Washington, DC 20037
(202) 857-2500

### Ponce

Placido Gonzales Cordova
P.O. Box 1161
Caguas, PR 00626

Robert J. Walser
G.P.O. Box AL
San Juan, PR 00936

### San Juan

International Broadcast Consultants
8070 Soquel Dr., Suite 260
Aptos, CA 95003
Robert A. Ruark, President
(408) 688-3992

Charles O. Verrill, Jr., Esq.
Patton, Boggs & Blow
2550 M St., N.W.
Washington, DC 20037

Victor Ginorio Gomet
Epedregal #7
Box 307
Humacao, PR 00661

## Tennesee

### Knoxville

Belwen, Inc.
7 Boyle Road
Scotia, NY 12302
Wayne E. Wagner, President
(618) 374-6079

Gerald Stevens-Kittner, Esq.
Fleischman & Walsh
1725 N St., N.W.
Washington, DC 20036

Capital Cities Entertainment
Systems, Inc.
1330 Avenue of the Americas
34th Floor
New York, NY 10019

Andrea Timko Sillet, Esq.
Wilmer, Cutler & Pickering
2445 M St., N.W.
Washington, DC 20037

### Memphis

Tel-Radio Communications Property
517 N. Segoe Road
Madison, WI 53105

## Texas

### Abilene

Kannew Broadcast Technolgies
c/o A. G. Newmyer III
1220 L St., N.W.
Washington, DC 20005
(202) 289-6300

Todd D. Gray, Esq.
Dow, Lohnes & Albertson
1255 23rd St., N.W.
Washington, DC 20037
(202) 857-2500

### Brownsville

MHT/Robert D. Hanna
P.O. Box 72254
Las Vegas, NV 89170

Joel R. Wolfson
1815 H St., N.W., Suite 600
Washington, DC 20006

El Paso

T/V Communications Associations
c/o Thompson Communications Corp.
5601 N. MacArthur Blvd.
Suite 210
Irving, TX 75062
Carl B. Hilliard, Jr.
(619) 231-3900

Houston

Block & Associates
3777 Boise Avenue
Los Angeles, CA 90066

San Antonio

Texas Wired Music Inc.
P.O. Box 8278
San Antonio, TX 78208

EXHIBIT D

MMDS
OPERATORS
8-1-87

✓**Metro TEN**
**1250 Granger Road**
**Cleveland, OH 44131-1234**
**Jim Theroux, Pres.**
**216-749-0500**

✓**Premier Communications**
**821 Malcom Road**
**Burlingame, CA 94010**
Jack Capuzelo, Pres.
415-697-3074

**Family Entertainment**
**210 N Main**
Mitchell, SD 57301
Kevin Johnson, G.M.
605-996-1200

De Fontes TV
P.O. Box HM 1450
Hamilton 5, Bermuda
Ken De Fontes, Owner
809-292-0050

Pennsylvania Pay TV
3600 Conshocken Ave
Philadelphia, PA 19131
Bill Cross, Pres.
215-487-3100

✓Microband
555 Third Ave
New York, NY 10017
Don Franco, Pres.
212-867-9590

✓T.V.-3
P.O. Box 21115
Billings, MT 59102
Doug Malmgren, Pres.
406-652-4280

Milwaukee Entertainment
P.O. Box 12546
Milwaukee, WI 53212-0546
Bruce Massey, Pres.
414-277-4026

Union City Microvision
Box 709
Union City, TN 38261
Joe Harpole, Pres.
901-885-3341

TDS
P.O. Box 415
Curacao, Netherland, Antilles
Norbert Hendrikse, [illegible]
599-961-1288

Tele-Cable of Puerto Rico
P.O. Box AE
Humacao, PR 00661
[illegible]
[illegible]

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## EXHIBIT E

## THE TREND TOWARD VERTICAL INTEGRATION BY CABLE INTO SATELLITE-DELIVERED PROGRAMMING*

| Network | Subscribers | Ownership |
|---|---|---|
| | Basic Services | |
| ESPN | 46,100,000 | Capital Cities/ABC (80%), RJR Nabisco (20%) |
| WTBS | 42,528,000 | Turner Broadcasting (Ted Turner 65%, Time Inc. [ATC] 11.5%, TCI 10.1%, UA 4.8%, United 3.2%, Warner 1.8%) |
| CNN | 42,528,000 | Turner Broadcasting (Ted Turner 65%, Time Inc. [ATC] 11.5%, TCI 10.1%, UA 4.8%, United 3.2%, Warner 1.8%) |
| USA | 41,000,000 | MCA (50%), Paramount (50%) |
| MTV | 39,400,000 | MTV Networks Inc. (Viacom) |
| Nashville | 37,000,000 | Gaylord Broadcasting |
| CBN | 37,212,000 | Christian Broadcasting Network |
| Nickelodeon | 37,900,000 | MTV Networks Inc. (Viacom) |
| Lifetime | 35,440,000 | CC/ABC (33%), (Viacom) (33%), Hearst (33%) |
| Weather Chan. | 31,600,000 | Landmark Communications (former parent of TeleCable) |
| Nick at Nite | 32,500,000 | MTV Networks Inc. (Viacom) |
| Headline News | 28,352,000 | Turner Broadcasting (Ted Turner 65%, Time Inc. [ATC] 11.5%, TCI 10.1%, UA 4.8%, United 3.2%, Warner 1.8%) |
| FNN | 27,300,000 | Infotech (20%), Dr. Earle Brian (15%) |
| A&E | 30,000,000 | CC/ABC (33%), (NBC) (33%), Hearst (33%) |

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*Statistics from Cablevision, vol. 12, no. 38 (Feb. 29, 1988), p. 106 and Broadcasting, vol. 113, no. 21 (Nov. 23, 1987), p. 41.

| Network | Subscribers | Ownership |
|---|---|---|
| Discovery | 27,494,000 | TCI (14%), United (14%), Cox (14%), Group W (14%), Newhouse (14%), management, New York Life Co., Allen & Co. (30%) |
| C-SPAN | 33,000,000 | Cable operator supported |
| VH-1 | 24,700,000 | MTV Networks Inc. (Viacom) |
| WGN | 23,888,216 | Tribune Broadcasting |
| Score | 19,800,000 | Infotech (20%), Dr. Earle Brian (15%) |
| CVN | 18,400,000 | COMB Co. (50%), 18 cable operators** |
| BET | 18,000,000 | Bob Johnson (51%), BET president, TCI (16%), HBO (16%), Taft (16%) |
| HSN I | 15,200,000 | Home Shopping Networks Inc. |
| C-SPAN II | 12,500,000 | Cable operator supported |
| Tempo TV | 14,500,000 | TCI |
| Telshop | 11,000,000 | Infotech (20%), Dr. Earle Brian (15%)*** |
| QVC Network | 11,200,000 | QVC Network (65%), Comcast (14%), cable operators (21%)**** |

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**CVN--The ownership by 18 cable operators--American, ATC, Adam Corp., Cablevision, Colony, Continental, Cooke, Daniels & Associates, Heritage, Newhouse, Rogers, Sammons, TCI, Times Mirror, United Artists, Viacom, Warner--is based on percentage of subscribers committed to service.

***Telshop--FNN is offering equity to cable operators (500,000 shares). FNN will retain two million shares.

****QVC Network--It is presently owned by the public (65%), Comcast (14%) and cable operators (21%). When cable operators exercise warrants on 483,000 shares of preferred stock, redeemable for 10 shares of common stock, another 4.83 million shares will be added to the approximately 10 million shares outstanding. At that point, cable operators would own approximately 8.5 million shares of the 15 million shares outstanding, or 56% of the service. The largest in that group would be TCI (2,150,000).

| Network | Subscribers | Ownership |
|---|---|---|
| Inspirational | 10,500,000 | PTL Club |
| Learning Chan. | 11,000,000 | Infotech (40%), Appalachian Community Service Network (40%), officers and employees (20%) |
| WWOR | 9,657,482 | MCA |
| Silent Network | 10,000,000 | Silent Network Inc. |
| Video Mall Net. | 14,000,000 | Video Shopping Mall (Goodway Marketing 80%) |
| Trinity | 7,037,000 | Trinity Broadcasting Network (nonprofit) |
| Eternal World TV | 7,100,000 | Eternal World Television (nonprofit) |
| Fashion Channel | 8,700,000 | Charlie Gee (32%), 65 cable operators (25%)***** TCI (10.5%), United (10.5%) |
| Country Music | 6,800,000 | Jim Guercio (principal owner) |
| Acts | 6,300,000 | Southern Baptist Convention |
| Travel Channel | 7,000,000 | TWA Marketing (100%), after equity offering TWAM will hold 63%, cable operators 37%****** |
| HSN II | 5,800,000 | Home Shopping Networks Inc. |

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*****Fashion Channel--Among the larger cable operators with an equity stake are Adelphia, American, ATC, Barden, Bresnan, Cablevision Industries, Centel, Century, Colony, Commonwealth Cablesystems, Continental, Cooke, Cox, Daniels, Enstar, First Carolina, Harron, Hauser, Heritage, Lenfest, Maclean Hunter, Marcus, Media General, Newhouse, Omega, Post Newsweek, Prestige, Sammons, Scripps Howard, Simmons, Susquehanna, Sutton Capital, Taft, TeleCable, TCI, Times Mirror, Triax, UA, United, United Video Cablevision, Viacom and Warner.

******Travel Channel--The final equity offering is to be placed by Dec. 1, whereby TWA Marketing will retain 6 million shares and cable operators will be offered 3.5 million.

| Network | Subscribers | Ownership |
|---|---|---|
| **Movietime** | 4,000,000 | Employees (30%), Mabon, Nugent & Co., SRK Management, Loeb Partners and Hallmark (70%) |
| **Shop TV** | 3,000,000 | JC Penney (63%) STN (37%)******* |
| **WPIX** | 8,875,212 | Tribune Broadcasting |
| **Hit Videc USA** | 2,164,000 | Wodlinger Broadcasting |
| **KTVT** | 3,502,352 | Gaylord Broadcasting |
| **Nostalgia** | 2,500,000 | **Cooke Cablevision (9%), TeleCable** subsidiary has small percentage, largest single owners |
| **Liberty** | 1,049,000 | Liberty Broadcasting Network (nonprofit) |
| **Consum.** Disc. II | 1,000,000 | Entertainment Marketing Inc. |
| **Sky Merchant** | 1,000,000 | Jones Int'l. (parent of Jones Intercable) |
| **America's Shop** | 1,000,000 | Cox Cable |
| **Galavision** | 1,000,000 | Univisa |
| **Gospel Music Net.** | 744,447 | GMN Ltd. |
| **Motivation Net.** | 200,000 | Rock Christian Network (nonprofit) |
| **CDN I** | 526,000 | Entertainment Marketing |

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*******Shop TV--It has equity commitments from 30 MSO's representing 3.3 million subscribers. MSO's will receive 1% equity in the service for each million himes they commit to. Cable operaors who have major stakes in other shopping programs, such as TCI, United and Comcast, are not a part of Shop. Among the MSO's whose systems are carrying Shop TV are Cablevision Systems, Rogers, Continental and Warner.

| Network | Subscribers | Ownership |
|---|---|---|
| | | Pay Services |
| **HBO** | 15,900,000 | **Time Inc.** |
| **AMC** | 9,000,000 | Rainbow Program Enterprises (Cablevision Systems) 50%, TCI 50% |
| **Showtime** | 5,700,000 | **Viacom** |
| **Cinemax** | 5,100,000 | **Time Inc.** |
| **Disney** | 3,810,000 | Walt Disney Co. |
| **Movie Channel** | 2,600,000 | **Viacom** |
| **Playboy** | 520,000 | Playboy Enterprises |
| **Bravo** | 1,000,000 | RPE (Cablevision Systems) |
| **Festival** | 30,000 | **Time Inc.** |
| | | Pay-per-view services |
| **View. Choice I, II** | 4,000,000 | **Viacom** |
| **Request TV** | 2,500,000 | **Daniels, United Cable, Centel, Heritage, American,** major motion picture studios |
| **Home Premiere** | 2,300,000 | General Instrument |
| **Cable Video Store** | 40,000 | **ATC**, Cox, **TeleCable Continental** and **Newhouse** 20% each. |

Bold face in right-hand column indicates cable operator ownership by company with cable systems in separate subsidiary

EXHIBIT F

## THE PROGRAMMING BOTTLENECK [1/]

| SERVICE | DESCRIPTION | NUMBER OF SUBSCRIBERS[2/] | AVAIL. METROTEN | DISCRIM. PRICE/TERMS TO METROTEN[3/] | AVAIL. MICROBAND | DISCRIM. PRICE/TERMS TO MICROBAND[4/] | CABLE OWNERSHIP IN WHOLE OR IN PART [5/] |
|---|---|---|---|---|---|---|---|
| I. BASIC | | | | | | | |
| A. ESPN | Sports | 46.1 million | YES[6/] | YES/YES | YES[7/] | YES/YES | 0% CABLE |

---

[1/] This chart illustrates the inability of wireless cable operators to obtain satellite-delivered programming at fair prices and terms, as well as the trend toward vertical integration by cable into such programming. In fact, as the chart reflects, many of the programmers refusing to deal with wireless cable at fair prices and terms are owned in whole or in part by the large MSOs. The chart focuses on the two largest wireless cable firms: Microband, which delivers programming in New York, NY, Detroit, MI and Washington, D.C., and Metroten, which serves the Cleveland, OH area.

/ Statistics from Cablevision, Vol. 12, no. 38, at 106 (Feb. 29, 1988).

/ Discriminatory Price refers to the situation where the wireless cable operator pays a higher price than cable operators for the same programming. Discriminatory Terms refers to the situation where the wireless cable operator's contract with the programmer contains less favorable non-price terms than the programmer's standard contract with cable operators. Such discriminatory terms have included geographic restrictions limiting service to areas unwired for cable and refusals to provide the equity options offered to cable operators.

/ Id.

/ Statistics from Broadcasting, Vol. 113, no. 21, at 41-42 (Nov. 23, 1987).

/ ESPN's NFL Package is not available to wireless cable customers in some cable wired areas.

/ Id.

| SERVICE | | DESCRIPTION | NUMBER OF SUBSCRIBERS | AVAIL. METROTEN | DISCRIM. PRICE/TERMS TO METROTEN | AVAIL. MICROBAND | DISCRIM. PRICE/TERMS TO MICROBAND | CABLE OWNERSHIP IN WHOLE OR IN PART |
|---|---|---|---|---|---|---|---|---|
| B. | **CABLE NEWS NETWORK** | News | 42.5 million | YES[8] | YES/NO | NO | N/A | **31.4% CABLE** |
| C. | **WTBS**[9] | Variety | 42.5 million | YES | N/A | YES | N/A | **31.4% CABLE** |
| D. | USA | Variety | 41 million | NO | N/A | NO | N/A | 0% CABLE |
| E. | **MTV** | Music | 39.4 million | YES | YES/NO | YES | YES/NO | **100% CABLE** |
| F. | **NICKELODEON** | Children | 37.9 million | YES | YES/NO | YES | YES/NO | **100% CABLE** |
| G. | CHRISTIAN BROADCAST NETWORK | Religious variety | 37.2 million | YES | NO/NO | YES | NO/NO | 0% CABLE |
| H. | NASHVILLE NETWORK | Music | 37 million | YES | YES/NO | YES | YES/NO | 0% CABLE |
| I. | **LIFETIME** | Variety | 35.4 million | NO | N/A | NO | N/A | **66% CABLE** |
| J. | C-SPAN | Government | 33 million | YES | NO/NO | YES | NO/NO | CABLE SUPPORTED |
| K. | WEATHER CHANNEL | Weather | 31.6 million | NO | N/A | NO | N/A | 0% |
| L. | **ARTS & ENTERTAINMENT** | Movies, variety | 30 million | NO | N/A | NO | N/A | **33% CABLE** |

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[8] Metroten is the only non-cable distributor of Cable News Network.

[9] As an independent broadcast network delivered by common-carrier, cable-owned WTBS may not discriminate as to retail affiliates.

| SERVICE | DESCRIPTION | NUMBER OF SUBSCRIBERS | AVAIL. METROTEN | DISCRIM. PRICE/TERMS TO METROTEN | AVAIL. MICROBAND | DISCRIM. PRICE/TERMS TO MICROBAND | CABLE OWNERSHIP IN WHOLE OR IN PART |
|---|---|---|---|---|---|---|---|
| M. **HEADLINE NEWS** | News | 28.3 million | YES | YES/NO | YES | YES/NO | **31.4% CABLE** |
| N. **DISCOVERY** | Science | 27.4 million | NO | N/A | NO | N/A | **70% CABLE** |
| O. FINANCIAL NEWS NETWORK | Financial | 27.3 million | YES | YES/NO | YES | YES/NO | 0% CABLE |
| P. WGN10/ | Variety | 23.8 million | YES | N/A | NO | N/A | 0% CABLE |
| Q. **BLACK ENTERTAINMENT TV** | Ethnic | 18 million | YES | NO/NO | YES (NY & DET)<br>NO (D.C.) | NO/NO | **54% CABLE** |
| R. HOME SHOPPING NETWORK | Shopping | 15.2 million | NO | N/A | NO | N/A | ?% CABLE |
| S. **TEMPO TV**11/ | Variety | 14.5 million | YES | NO/NO | YES | NO/NO | **100% CABLE** |
| T. LEARNING CHANNEL | Educational | 11 million | YES | NO/NO | YES | NO/NO | 0% CABLE |
| U. WOR12/ | Variety | 9.6 million | YES | N/A | YES | N/A | 0% CABLE |

---

10/ As an independent broadcast network delivered by common-carrier, WGN may not discriminate as to retail affiliates.

11/ Tempo TV is the common carrier for WTBS. With its recent acquisition of Tempo TV, Tele-Communications, Inc. (TCI) now owns 10.1% of Turner Broadcasting System. It is widely anticipated that Tempo TV will serve as a launch platform for Turner Network Televion (TNT). TCI is interested in starting a new network-quality satellite-delivered channel as is Turner Broadcasting System. While Tempo TV has previously been available to wireless cable, Turner has explicity proposed making TNT a cable-exclusive service. If TCI denied wireless cable access to TNT, the anticompetitive effect would be even greater than the denial of access to the existing Tempo TV.

12/ As an independent broadcast network delivered by common-carrier, WOR may not discriminate as to retail affiliates.

| SERVICE | DESCRIPTION | NUMBER OF SUBSCRIBERS | AVAIL. METROTEN | DISCRIM. PRICE/TERMS TO METROTEN | AVAIL. MICROBAND | DISCRIM. PRICE/TERMS TO MICROBAND | CABLE OWNERSHIP IN WHOLE OR IN PART |
|---|---|---|---|---|---|---|---|
| V. **FASHION CHANNEL** | Shopping | 8 million | NO | N/A | NO | N/A | 46% CABLE |
| W. **TRAVEL CHANNEL** | Travel | 7 million | N/A | N/A | YES | NO/YES | 37% CABLE |
| X. NOSTALGIA CHANNEL | Vintage movies | 2.5 million | YES | NO/NO | YES | NO/NO | 0% CABLE |
| Y. MADISON SQUARE GARDEN | Local sports | 2.1 million | N/A | N/A | YES | ?/YES | 0% CABLE |
| Z. GALAVISION | Spanish variety | 1 million | N/A | N/A | YES | NO/NO | 0% CABLE |
| II. PREMIUM | | | | | | | |
| A. HBO | Movies, specials, orig. programs | 15.9 million | NO | N/A | YES | YES/YES | 100% CABLE |
| B. **AMERICAN MOVIE CLASSICS** | Vintage movies | 9 million | NO | N/A | NO | N/A | 100% CABLE |
| C. **SHOWTIME** | Movies | 5.7 million | YES13/ | YES/YES | NO | N/A | 100% CABLE |
| D. **CINEMAX** | Movies | 5.1 million | NO | N/A | NO | N/A | 100% CABLE |
| E. DISNEY CHANNEL | Family | 3.8 million | NO | N/A | NO | N/A | 0% CABLE |
| F. **MOVIE CHANNEL** | Movies | 2.6 million | NO | N/A | NO | N/A | 100% CABLE |
| G. **BRAVO** | Cultural | 1 million | NO | N/A | NO | N/A | 10% CABLE |

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13/ Metroten carries Showtime as a result of the settlement of an antitrust lawsuit.

| SERVICE | DESCRIPTION | NUMBER OF SUBSCRIBERS | AVAIL. METROTEN | DISCRIM. PRICE/TERMS TO METROTEN | AVAIL. MICROBAND | DISCRIM. PRICE/TERMS TO MICROBAND | CABLE OWNERSHIP IN WHOLE OR IN PART |
|---|---|---|---|---|---|---|---|
| H. SPORTS CHANNEL | Sports | 45,000 (FLA); 800,000 (NEW ENGLAND); 1 MILLION (NEW YORK) | N/A | N/A | NO | N/A | 100% CABLE |
| I. FESTIVAL | Variety | 30,000 | NO | N/A | NO | N/A | 100% CABLE |

EXHIBIT G

THE
Fashion
CHANNEL

November 19, 1987

Margaret Robinson
Metropolitan Cablevision
1250 Granger Rd.
Brooklyn Heights, OH 44131

Dear Maggie:

Per your request, I've enclosed some information on The Fashion Channel. Thank you, again, for your interest in our service; however, at this time The Fashion Channel is unable to offer our service to "Metro 10". We are currently a cable exclusive shopping service and are presently affiliated with North Coast Cable of Cleveland.

Maggie, when we talked, I was unaware of this information. I hope that the information is helpful to you even though we will be unable to affiliate with your company at this time. Should our board of directors decide to change this policy and offer service to MMDS companies, I will be sure to let you know.

Thanks, again, for your call. I wish you and "Metro 10" much success!

Sincerely,

Leah Lyles Bradley

Leah Lyles Bradley
Regional Manager

LLB/tt

Enclosures

cc: Morgan Lambert Howe

2300 Computer Ave., I-46
Willow Grove, PA 19090
215-657-2005

**EXHIBIT H**

## A DYNAMITE TEMPO FOR TCI

Tele-Communications, Inc., will add Tempo TV to its program holdings, which already include equity in Turner Bcstg., American Movie Classics, Black Entertainment TV, Cable Value Network, QVC Network and The Fashion Channel.

Tempo TV, the 12.5 mil.-sub network in the process of reconfiguring its programming to appeal to the 45+ demographic, is a subsidiary of Tempo Enterprises. Other Tempo holdings include the distribution of WTBS via satellite, cable systems serving 17,000 subs and two independent TV stations.

TCI has offered--and the Tempo board has agreed--to exchange 5.6 mil. shares of Tempo stock valued at $8/share for TCI stock valued at $21/share at a 2.625:1 ratio.

The TCI offer values all of Tempo's assets at only $45 mil. (Tempo has traded as high as $21.25/share--equal to $120 mil.--last year when the network dabbled briefly with carriage of home shopping programs).

From Tempo's perspective, the deal feels closer to $16/share--$90 mil. in total value--because it believes TCI stock is privately worth twice its current quote (CABLE TV INVESTOR #399, 11/17/87).

We reach a private market value for Tempo TV of $50 mil. by adding up the company's separate pieces and subtracting them from the $90 mil. value:

| | |
|---|---|
| Total private market value of Tempo Enterprises.... | $90 mil. |
| Cable systems (17,000 subs @ $1,500)............... | 25 mil. |
| WTBS satellite distribution ($5 mil. in c.f.)...... | 25 mil. |
| Miscellaneous assets.............................. | 5 mil. |
| Subtotal.......................................... | $55 mil. |
| Debt.............................................. | 15 mil. |
| Value net of debt................................. | $40 mil. |
| Tempo TV PMV...................................... | $50 mil. |

*© 1987 CABLE TV PROGRAMMING. Estimates of Paul Kagan Associates, Inc.*

The network, which in the past has sold most of its program time directly to producers, has generated cash flow as high as $5.5 mil. as recently as 1986 (see table, P. 2).

Expenses associated with its program reorientation plans are expected to bring cash flow temporarily below breakeven in 1988 (a $153,000 loss is budgeted), but a return to profitability is foreseen for succeeding years: $2.8 mil. in 1989, $6.8 mil. in 1990 and $12.4 mil. in 1991.

Those pro forma cash flows and a $50 mil. valuation would imply Tempo TV sold for 17.8x 1989 c.f., 7.3x 1990 c.f. and 4x 1991 c.f.

Our analysis assumes TCI would allow the network to follow its current business plan (CTP #112, 8/31/87). But Tempo TV could serve another purpose: a launch platform for Turner Network Television (TNT).

Tempo's 6 mil.-7 mil. full-time subs (of its 12.5 mil. total) could solve some of the tight channel-capacity objections voiced by cable operators recently approached with the TNT proposal (CTP #114, 10/29/87).

Whatever the outcome, TCI's acquisition could prove a tonic for Tempo, whose sub counts stalled the past two years.

First, MSOs objected to a plan to add license fees, then Tempo made an abortive attempt to carry home shopping part-time.

TCI's position as an equity investor--despite being viewed negatively by some MSOs--has helped other networks, such as The Discovery Channel, CVN and TFC, grow rapidly.

FRONT LINE

# Tempo deal expands TCI reach

NEW YORK—In a deal that will give TCI a foothold in the nascent TVRO business and further its involvement in programming, the country's largest multiple system operator has agreed to acquire Tempo Enterprises in a transaction valued at $61 million. The merger agreement provides for an exchange of TCI stock valued at $21 a share for stock of Tempo Enterprises at $8 a share. Tempo shareholders have the option of receiving $8 in cash for their holdings or converting their shares into TCI stock at a ratio of 2.625 to one. On Nov. 6, the last trading day before the deal was announced, Tempo closed at $7 a share.

Tempo Enterprises, formerly known as Satellite Syndicated Systems, is the common carrier for Superstation WTBS. In addition, it owns and manages Tempo Television, a 24-hour basic cable network with 12 million subscribers; cable systems serving 16,000 subscribers in the Southwest; and Tempo Development Corp., a packager of satellite programming to the backyard dish market.

The primary attractions to Tempo Enterprises for TCI, say industry sources, are its programming network and TVRO business. John Malone, president and chief executive officer of TCI, has been touting his interest in expanding TCI's involvement in the programming business for over a year now. Two months ago, he told a group of institutional investors that he would like TCI to have a percentage interest in programming equal to that in system operations (*CV* 9/28/87 p. 12). "This is a real 'in' into the programming market," says Gene Gawthrop, executive vice president at Communications Equity Associates, which represented Tempo Enterprises in the negotiations. "The bulk of the deal's value is in the network" and the license to transmit WTBS, he notes.

The common carrier business generates $5 million a year in cash flow. Not only will TCI gain access to that flow of money, but also it will gain immediate cost savings by controlling the service. The risk is that either the reimposition of syndicated exclusivity or the elimination of the compulsory license could mean the end of superstations entirely.

Malone has said WTBS could be converted to a basic network at that point, and until the legal and regulatory issues are resolved, Turner Broadcasting could start another channel. TBS is exploring that possibility now under the working title of Turner Network Television (see separate story, page 36).

As Steve Effros, president of the Community Antenna Television Association, notes, Tempo Television could provide the vehicle for TNT. "With a transponder and an existing audience," the building blocks are there.

Just as important an attraction to TCI is Tempo Development Corp. "This is a very important part of the deal," says Marty Lafferty, president of Tempo Development. "TCI has big plans to pursue the TVRO market" much more aggressively than it has in the past, he says. "We're on a very fast track," and TCI has had "the opportunity to study us closely," says Lafferty.

Part of the plans for Tempo Development reportedly include merging those operations with those of Netlink USA, which provides cable operators and TVRO owners with the signals of the three broadcast network affiliates in Denver, the Denver PBS station, and two Denver area independent television stations. Tempo Development is designed to serve the TVRO market with packages of cable programming. TCI owns 40 percent of Netlink USA; Western Tele-Communications Inc. owns another 40 percent, and Netlink founder Gordon Rock owns 20 percent.

According to Lafferty, estimates are that the total TVRO market, if C-band satellites continue to be used, will be 5 million households, a number which equals TCI's own subscriber figure of wholly-owned systems. If the market moves on to K-band satellites, it could be much larger. At this time, there are 275,000 descramblers in place, but according to Lafferty, that number could leap in coming months.

Tempo Development now serves 42,000 TVRO subscribers, Lafferty says, after just six weeks of marketing. The company offers two services: one direct to TVRO customers, which allows them to pick their own packages of cable programming services, and another to cable operators, which offers dish owners three types of packages.

The key point in the latter service is that the operators negotiate for the TVRO rights directly with the programmers. Tempo Development is responsible for handling calls from the operators themselves or the customers, authorizing the TVRO owner's receiver for the appropriate programming services, and then billing the customers and collecting monthly payments.

While Tempo Enterprises has been an enthusiastic backer of the TVRO service, Lafferty notes that TCI's greater financial resources should allow the service to move into new areas.

The deal is contingent on receiving an acceptable fairness opinion, the approval of the Tempo Enterprises shareholders, and various regulatory approvals. Because of the size of the transaction TCI must make a filing under the Hart-Scott-Rodino antitrust amendments. In addition, the Federal Communications Commission must approve the transfer of Tempo's common carrier license for WTBS, the transfer of the cable system CARS licenses and several broadcast licenses.

As is the case every time TCI makes another acquisition, new questions arise about whether this is the deal where the Justice Department finally tells the company it cannot grow any more.

In this case, questions of antitrust are not likely to center around the cable systems, but rather around TCI's further moves into programming and its entrance into the TVRO market. Department of Justice inquiries in recent years have focused on the ability of alternative delivery mechanisms to provide cable programming to subscribers. If TCI gains control over one of those delivery mechanisms—the TVRO market—that would raise substantial questions. However, industry attorneys note that the market for TVRO program packagers is still highly decentralized, that there are a number of packaging services, and that entrance into that market still is easy.

Where TCI could run into regulatory problems is in its bid to control Tempo's common carrier license. A broadcaster cannot control its common carrier, and several years ago the FCC forced Ted Turner to divest Satellite Syndicated Systems. Turner sold it to Ed Taylor, now chairman of Tempo Enterprises, for $1. Since TCI already owns a percentage of Turner Broadcasting, it is possible the company could run up against that prohibition.

*—Virginia Munger Kahn*

RADIO TELEVISION CABLE SATELLITE
Broadcasting Mar 14

■ **Wireless cable.** Wireless Cable Association, increasingly active trade association representing wireless cable operators, filed comments on Tele-Communications Inc.'s proposed $46-million purchase of Tempo Enterprises Inc., saying that TCI should provide assurances that Tempo programing and that of other services in which it has interest will be available to wireless cable operators and other potential competitors of cable. Assurances are necessary because of TCI's growing vertical integration with programers.

Wireless cable, which uses mix of ITFS and MDS channels to broadcast multiple cable programing services to subscribers, is now available in such large markets as New York, Detroit and Cleveland.

FCC has turned down request by Cablevision Systems, MSO with franchise for about one million homes within Microband-targeted market, to bar Microband Companies Inc. from offering its service in outer boroughs of New York until other channels now hung up in interference disputes become available and Cablevision can offer competitive wireless cable service. In responding to Cablevision's petition, Microband charged that Cablevision was trying to use FCC to block competition. It also alleged three cable programing services affiliated with Cablevision—SportsChannel New York, American Movie Classics and Bravo—have refused to deal with Microband in effort to weaken Microband's ability to compete.

Multichannel News — March 14, 1988

### Cabbages & Kings

# Ops' Exclusivity Not Worth the Trouble

**By Thomas P. Southwick**

DENVER — It must have seemed like a good idea at the time, but it is proving to be more trouble than it is worth.

The issue is exclusivity — granting a cable system the sole right to distribute a particular programming service within the system's franchise area.

HBO was first out of the box, with an offer of "wireline exclusivity" designed to protect against overbuilders (but not against alternative technologies such as multichannel MDS) at a cost to MSOs of 25 cents per sub per month.

Showtime quickly upped the ante, offering a defense against both overbuilders and Ku satellite delivery. (HBO has long been a backer of Ku-band delivery to cable systems.) Most of the other services have their own versions of exclusivity on the drawing boards.

But all this fun just had to end somewhere, and one could just count on a U.S. senator to provide the wet blanket. It came in the form of a letter from Sen. John Kerry (D-MA), who questioned the antitrust implications of the HBO proposal.

Sen. Kerry may be right or wrong. HBO has a plausible defense: that many businesses (movie studios, automobile manufacturers, etc.) offer exclusive distribution rights to their affiliates.

But the Kerry letter is only the first robin of spring; many more are on the way. There is a perception in Washington that cable is an uncontrolled monopoly out to gain a death grip on the televison sets of America. It doesn't matter whether that is true. In politics, perception is 90 percent of the game; exclusive deals can only add to that perception.

And the benefits of exclusive contracts do not warrant the risk that it might provide just the impetus for a brand new attorney general or some zealous congressional committee to launch a crusade against cable.

If somebody comes along with a better distribution system — be it a better cable system, fiberoptics, MMDS or something still undreamed of — the cable programming services will, in short order, either accommodate themselves to the new delivery system or watch some upstart programmer emerge to fill the vacuum.

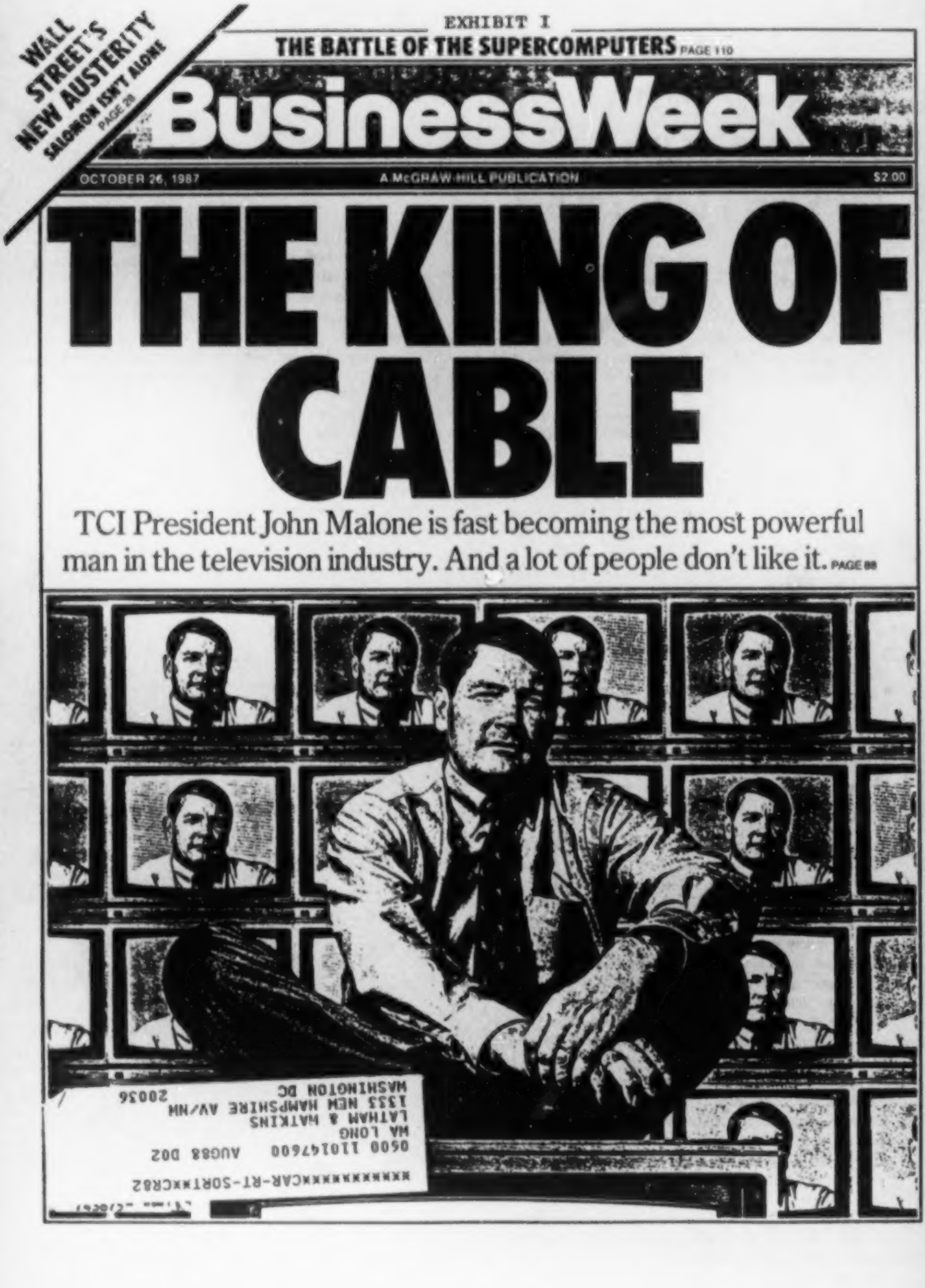
In such an environment, it won't be long before cable's exclusive deals are worth about as much as exclusive rights to sell horseshoes were when Henry Ford came along.

The only real protection cable operators have from competition is to provide good service at a reasonable cost, and to stay a jump ahead of the programming and technology, adding new services and adopting such new developments as fiber or high-definition television as they come along.

As long as cable operators do this, they will have little to fear from overbuilders or alternative technologies (at least those that now exist).

But where systems provide poor service at inflated prices and decline to add new services and keep pace with the technology, all the pieces of paper in the world from Showtime and HBO won't — and shouldn't — save their financial skins. ☐

EXHIBIT I



THE BATTLE OF THE SUPERCOMPUTERS PAGE 110

WALL STREET'S NEW AUSTERITY
SALOMON ISN'T ALONE PAGE 28

BusinessWeek

OCTOBER 26, 1987
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THE KING OF CABLE

TCI President John Malone is fast becoming the most powerful man in the television industry. And a lot of people don't like it. PAGE 88

# THE KING OF CABLE TV

## MEET THE MAN WHO MAKES THE NETWORKS TREMBLE

Time was running out for James M. Hoak Jr. The president of Heritage Communications Inc. didn't know last January if he could beat the raiders preparing to put his cable-television company in play. So Hoak flew from his Des Moines headquarters to Denver, hoping to be rescued by the one man he knew could make a quick deal—John C. Malone, president of Tele-Communications Inc. In just two hours, says Hoak, they shook hands on Malone's proposal: TCI would pay $1.3 billion for Heritage and keep Hoak's management team in place. It was the largest amount Malone had ever paid for a single company. Hoak left grateful and considerably awed.

Malone has been a big spender for close to three years now. In that time he has shelled out nearly $3 billion for more than 150 cable companies. The result is that one out of every five cable subscribers plugs into a TCI-controlled system, giving the company twice as many customers as its closest rival: Time Inc.'s American Television & Communications Corp. And Malone is now eyeing Storer Communications Inc.—the country's fourth-largest cable company. It is expected to be sold for around $3 billion.

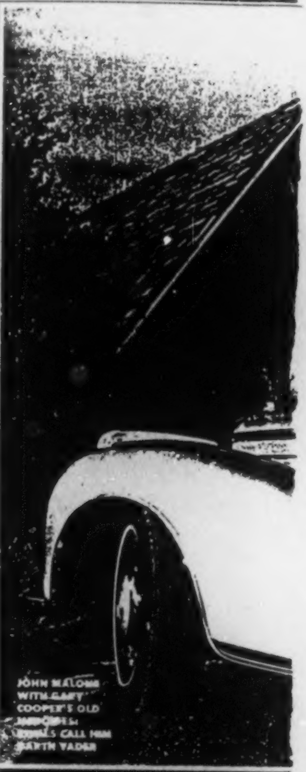
His acquisitions have made Malone, 46, the king of cable and, as the cable industry grows, possibly the most powerful man in television. Broadcasters and cable networks still decide what programs to offer, but Malone can decide whether or not to show them to his subscribers. That makes Malone a formidable gatekeeper now that nearly half the country's viewers subscribe to cable instead of using antennas as they once did to pick up broadcast signals for free.

TCI and other operators are big shots in their franchise areas because theirs is usually the only game in town. Operators don't have direct competition, and they have been able to set their own rates since January, when the industry was deregulated. Operators own the hardware—cable and overhead wire—that feeds the software, or programs, to subscribers' homes. An operator can break a local low-rated station, especially a public or independent broadcaster, by refusing to carry its programs. Local subscribers see only the national services operators choose to buy, such as Christian Broadcast Network, the Spanish-language Univision Inc. programs, kid's shows on Nickelodeon, the Black Entertainment Television Network, or the Arts & Entertainment Network.

But Malone is more formidable than any other cable operator because it's virtually impossible to make money from a cable network without TCI's 8 million subscribers. Indeed, Malone's support has launched fledgling networks, and his opposition has kept others from getting off the ground. Even producers of established cable programs, such as MTV and ESPN, have learned that it's risky to try to charge their biggest customer more than he's willing to pay. Other cable operators rarely challenge Malone, even when he negotiates deals that affect the entire industry.

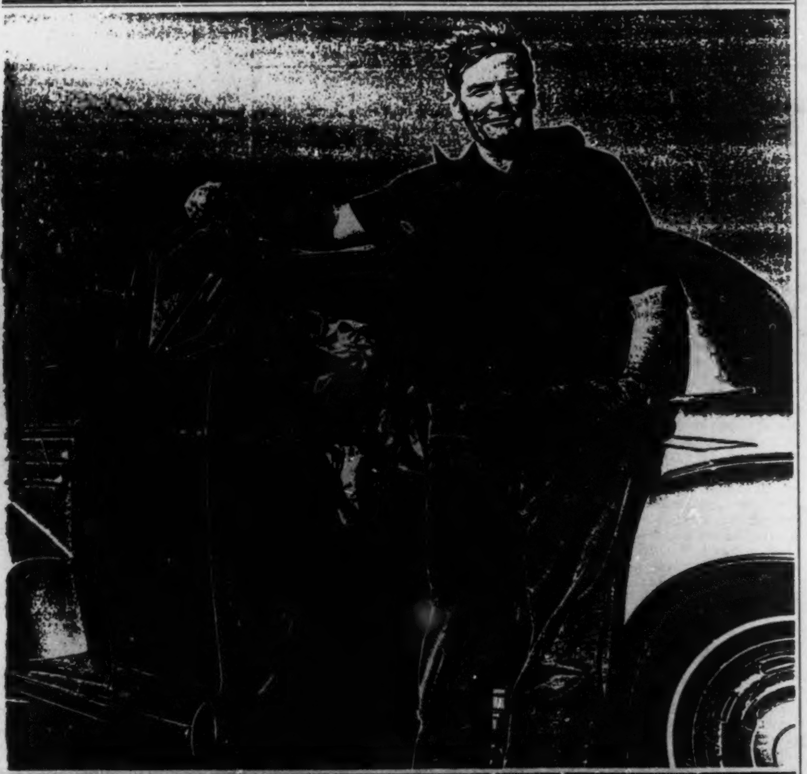
**A FREE HAND.** Malone has made his clout felt. He was the driving force behind a deal that prevented Hollywood or the networks from getting a piece of Ted Turner's debt-plagued Turner Broadcasting System Inc. (page 96). So powerful is TCI that right after Sumner M. Redstone, CEO of National Amusement Corp., bought Viacom International Inc., he made a courtesy call on Malone. Viacom owns several cable franchises and programming services, such as Showtime/The Movie Channel and MTV. And even NBC Inc. chief Robert Wright, who is busily talking up the prospects of starting the network's own cable channel, is wooing Malone.

Those who have been on the opposite side of the table in business deals say Malone is a bully, that he uses his financial muscle ruthlessly. Malone, the holder of five college degrees, frequently salts his conversation with profanity. He doesn't think much of some TV network chiefs and dismisses them, in less-than-



JOHN MALONE WITH GARY COOPER'S OLD [illegible]: [illegible] CALL HIM DARTH VADER

[illegible]: "ANYTHING'S POSSIBLE" FOR CABLE



HE FOUNDED TCI AND GAVE MALONE HIS START IN CABLE

BLAIR: MALONE PUT HIM IN CHARGE OF UA

PHOTOGRAPHS BY CHARLES THATCHER

polite language, as self-impressed effete snobs. He doesn't have to clear his statements with anybody at TCI and has pretty much a free hand in dealmaking. Malone and Bob Magness, TCI's chairman and founder, own more than half of the company's voting shares.

In early 1986 financier Irwin L. Jacobs saw Malone in action. Malone wanted a big piece of the fast-growing business of home-shopping programs, which was dominated by an independent company, Home Shopping Network Inc. Jacobs also wanted in through a discount merchandiser, COMB Co., where he is a director. He knew he would need Malone's help to launch a new cable channel and invited the TCI chief to meet him in Minneapolis. In less than an hour they had a tentative deal: Malone promised to deliver enough cable outlets to give the venture a good send-off. In return, Malone asked for a fairly large stake in COMB's Cable Value Network. Jacobs agreed. Now 32 operators own half of the recently reorganized parent company—called CVN Cos.—and the shopping channel is shown on 104 systems. The profitable channel should generate more than $300 million in revenues this year.

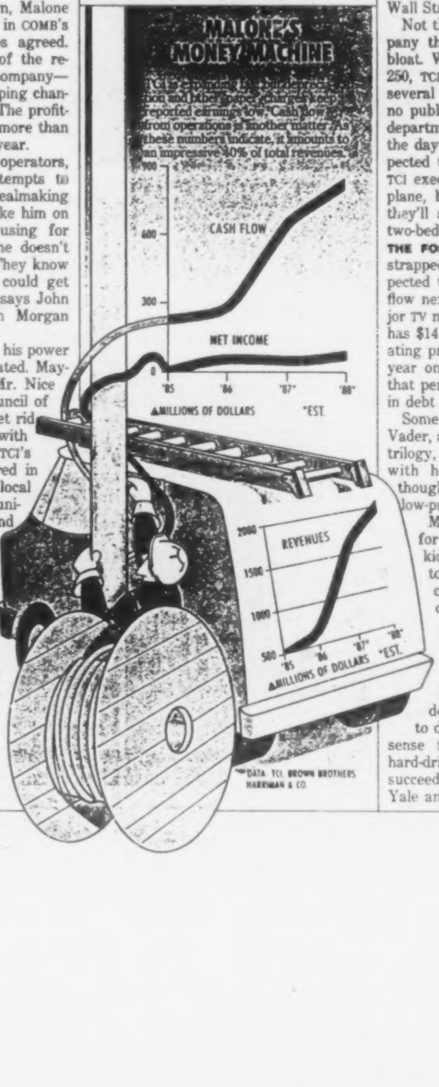
**'FROZEN OUT.'** Some cable operators, however, resent Malone's attempts to play them like cards in his dealmaking hand. But they're afraid to take him on publicly, reserving their grousing for private, safe occasions. Malone doesn't have to threaten operators. "They know if they don't go along, they could get frozen out of the next deal," says John Tinker, a cable analyst with Morgan Stanley & Co.

Malone says the accounts of his power and ruthlessness are exaggerated. Maybe so, but Malone was not Mr. Nice Guy in 1981 when the city council of Jefferson City, Mo., tried to get rid of TCI. The council, unhappy with TCI's service, planned to yank TCI's cable franchise when it expired in 1982 and turn it over to a local company, Central Telecommunications Inc. TCI sued the city and threatened to undermine any cable company that took its place. A U. S. Court of Appeals judge found that TCI said it would cut off service and let its cable wires rot rather than sell to another cable provider. TCI also tried to intimidate the city by vowing to sell satellite dishes at low prices.

After the city council caved in, Central Telecommunications, the local cable operator, charged TCI with restraint of trade. Early this year the U. S. Supreme Court declined to hear an appeal of a lower court's judgment against TCI, a decision that cost the company nearly $44 million.

The judgment is not the kind of publicity the cable industry can afford these days. With consumer complaints on the rise, Congress is seriously looking at re-regulating the cable operators. "They're rapidly becoming the newest generation of robber barons," says Larry Munroe, president of Municon Inc., a consultant to cities on cable matters. And the ubiquitous Jack J. Valenti, president and CEO of the powerful Motion Picture Association of America, says cable operators have abused the freedom they've had since January to raise rates and shift channels around on the dial at will.

Foreseeing the possibility that Congress, or federal regulators, might limit the size of cable companies, Malone began decentralizing TCI in early 1986. He cut the company into six separate divisions, each nearly autonomous with its own marketing, accounting, and engineering departments. If forced, Malone plans to spin off the companies to shareholders—much as American Telephone & Telegraph Co. was broken up. He's even thinking of restructuring the company without a push from Washington. "We might do it if it looks like we're getting too big, or unwieldy, or if our stock's too undervalued," he says.


MALONE'S MONEY MACHINE

TCI is expanding fast, but depreciation and other paper charges keep reported earnings low. Cash flow from operations is another matter. As these numbers indicate, it amounts to an impressive 40% of total revenues.

DATA: TCI, BROWN BROTHERS HARRIMAN & CO.

ROB DOYLE/BW

TCI stock has soared 66% since January, to 25, but some Wall Street analysts believe TCI still sells for less than the company is worth. Malone rarely worries that his deals will dilute earnings. "We've never bowed to the whims of Wall Street," declares founder Magness.

Not that Wall Street objects to a company that shows virtually no signs of bloat. With a corporate payroll of only 250, TCI has secretaries who work for several different executives. There are no public relations or human resources departments. Ten senior executives run the day-to-day business, and each is expected to handle different departments. TCI executives can fly on the corporate plane, but when they visit New York, they'll sleep at the company's spartan two-bedroom downtown apartment.

**THE FORCE.** The TCI empire is hardly strapped for spending money. It is expected to generate $850 million in cash flow next year, more than all three major TV networks combined. The company has $14 billion in total assets, and operating profits should hit $285 million this year on revenues of $1.7 billion. Given that performance, even TCI's $4.6 billion in debt seems manageable.

Some have nicknamed Malone Darth Vader, after the villain in the *Star Wars* trilogy, and the Force does seem to be with him. For all Malone's power, though, few people really know the low-profile executive and dealmaker.

Malone first showed his keen eye for an opportunity when he was a kid growing up in the affluent town of Milford, Conn. He bought old surplus General Electric radios for $1 apiece, fixed them up, and resold them for $7. His father, a GE engineer and inventor, encouraged Malone to study engineering. He was fascinated by it. "Instead of getting bogged down in fancy analysis, I learned to develop an educated feel or horse sense for things," says Malone. His hard-driving father expected Malone to succeed. And he did, earning degrees at Yale and then at Johns Hopkins.

But by then, Malone was weary of academia. In 1967 he joined management consultants McKinsey & Co. and, later, General Instrument Corp.'s Jerrold Distribution Systems Div., which sold cable equipment. Malone learned a lot about hardware, but learned even more about how to deal with people. Though only 29, he managed to win the trust and loyalty of his cable operator customers. Years later the same customers remembered how Malone extended their credit while they were scratching to make it in the infant industry.

One customer, former Texas rancher Bob Magness, showed his gratitude in 1973 by offering Malone the opportunity that launched his career. Magness, who raised the money to start TCI by selling some of his cattle, needed someone who could run his small cable company, which he based in Denver in 1965 to serve tiny towns in Montana, Utah, Nevada, and Colorado. Malone, an outdoorsman, had had his fill of New York and wanted freedom to run a business. So he turned down the offer of a higher-paying cable job with Warner Amex Cable Communications and joined TCI. The 32-year-old Malone, with a PhD in operations research—a combination of math and engineering—under his arm, was considered a novelty, "a rocket scientist," recalls one employee.

**HITTING BOTTOM.** Malone arrived in Denver to find that TCI was in trouble. Interest rates were soaring, the stock market had taken a dive, and TCI risked defaulting on millions of dollars in loans. "We were lower than whaleshit," says Malone. He showed his mettle on one of his first jobs: The city council of Vail, Colo., was clamoring for more services but didn't want to approve higher rates, so Malone cut all programming for one weekend, and instead flashed the mayor and city manager's names and phone numbers on the screen. The city surrendered, but TCI soon sold the system.

For the next two years, Malone fought city cable regulators throughout the country and negotiated with bankers. His efforts began to show results in 1977 when he succeeded in getting a $77 million line of credit that allowed the company to refinance its debt. A moderate drinker, Malone says he "drank more booze that night than any night in my life."

Most of TCI's cable systems were in small suburbs and rural areas, but Malone had his eye on the big time. He stayed out of the big-city franchise bidding wars of the late 1970s and bided his time. He had to wait a couple of years, all the while fattening up his treasury. Thus, TCI was ready to pick up the pieces when operators found they couldn't fulfill their extravagant promises. Pittsburgh was a model. After losing millions

## THIS TOWN FOUGHT TCI AND WON—WELL, SORT OF

SUB
TV
SUB TV

SPICER (RIGHT) AND FELLOW ACTIVIST: "IT WAS LIKE THE STORMING OF THE BASTILLE"

For Ronald D. Spicer, the Luciano Pavarotti incident was the ultimate outrage. The retired musician tuned in last Dec. 29 for a Pavarotti TV special only to discover that Channel 7 no longer carried public television. Instead, he got a home-shopping program. An irate Spicer marched straight down to the local Tele-Communications Inc. office in Springfield, a small mill town in western Oregon, to complain and found 500 other furious viewers there. "It was like the storming of the Bastille," Spicer recalls. But the mob found TCI's doors locked. "They conveniently closed down for a four-day holiday," says Spicer.

It didn't take long for TCI to acknowledge its gaffe. A week later it put the station back in the same spot on the dial. But that didn't placate Spicer. He says that since 1985, when TCI became the franchise owner, rates have doubled and service has deteriorated. He and a few stalwarts decided they weren't going to take it anymore.

**'WORST CULPRIT.'** The rebellion produced a referendum last June that will allow the Springfield Utility Board (SUB) to build a cable service in competition with TCI. The SUB has commissioned a study to help it decide by February whether to go ahead. "People call from all over and ask me how we did it and how they can get started," says SUB spokeswoman Mary Ann Rhodes. "I tell them we didn't do it, the citizens did it."

The fight cost both sides a lot of money. A TCI-sponsored group opposing the referendum, Springfield Taxpayers Against Subsidizing Cable TV, put $45,000 into TV ads and mailings. The rebel group, Cable TV Freedom, spent $12,000—about $10,000 of which came from the Washington-based Association of Independent Television Stations (INTV). James B. Hedlund, INTV's vice-president, calls TCI "the country's worst culprit in abusing independent stations."

Shortly after the vote, which the rebels won by the slimmest of margins, TCI executives flew in from Denver to mend fences. TCI contributed $2,500 to the annual broiled chicken festival. Donations went to other local events.

Why doesn't TCI simply give its subscribers in Springfield what they want? After all, the 11,000 customers are hardly a ripple in the company's overall revenue stream, and the rebels merely want fewer channels and a lower basic rate. TCI responds that the opposition does not represent all the subscribers. "The system's growing, people are happy," says J. C. Sparkman, TCI's executive vice-president. "No one should complain about paying $16 for [31] channels."

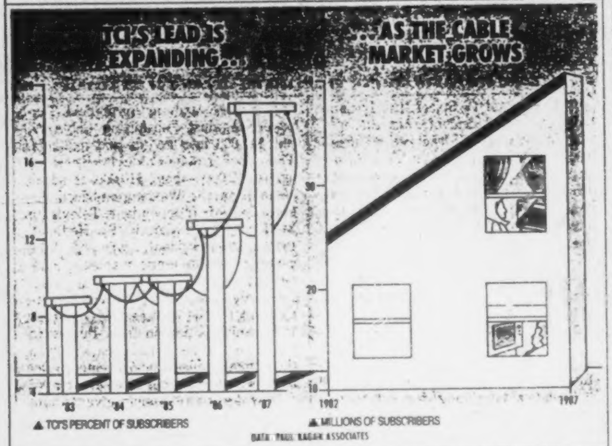
One casualty of TCI's programming decisions is Eugene's KLSR, an independent station in nearby Eugene that TCI claims it doesn't have room for. The low-powered KLSR may have to share a spot on the dial with a local-government access channel. "It's not great, but it's better than nothing," says KLSR's President John E. Field.

*By Katherine M. Hafner in Springfield*

of dollars there, Warner Amex sold the franchise to TCI for a bargain $93 million in 1984. Malone told the Pittsburgh city fathers that his company would supply only a bare-bones system. The city agreed, and TCI dismantled expensive equipment, closed showcase studios, and slashed payrolls by 47%. The posh downtown headquarters was moved to a former tire warehouse; the number of channels was cut from 60 to 49.

Only four years later the Pittsburgh system is producing about $14 million a year in cash flow. Despite rate hikes, the city is pleased. TCI used the same formula in franchises it launched or bought in Washington, St. Louis, and Chicago.

Despite the status he has won, Malone doesn't frequent the Denver social scene. Business and political functions leave him cold. A devoted family man, Malone often drives eight miles home for lunch and avoids working weekends so he can spend time with his wife and two children. The 6-ft., 1-in. executive prefers a casual air at work, too—he despises memos, red tape, and office politics. He's apt to wear slacks and knit shirts instead of suits. A passionate sailor, he has decorated his office with ship models and a brass ship's wheel.



DATA: PAUL KAGAN ASSOCIATES

ROB DOYLE/BW

Malone lives comfortably at his A-frame house near Denver, with a pool, pond, and indoor riding ring for his horses. His collection of antique cars includes Gary Cooper's old Mercedes. He pulls down a modest $350,000-a-year salary, but his TCI stock is worth $40 million. Malone owns resort homes in New Mexico and on the coast of Maine. An Easterner at heart, Malone regularly retreats to his 200-acre hilltop property above Boothbay Harbor, where he's restoring a New England-style house built early in this century. Malone pilots a 59-ft. Hinckley Sou'Wester sailboat and is not above turning a penny by operating a small marina and boatyard near his vacation home.

Friends and business associates say Malone loves dealing even more than he loves sailing. His extensive network of associates in the industry suggest the 20 to 30 deals he considers each month. Usually he'll call colleagues and investment bankers for information, but he often finds he knows more than they do. "John can reel off details about a little system he hasn't seen in two years," says William J. Bresnan, president of one TCI subsidiary.

Malone's dealmaking skills, and patience, were tested over the three years he courted Robert and Marshall Naify, the reclusive brothers who controlled United Artists Communications Inc. Finally, in late 1985, when they decided to sell their 55% stake in UA, Malone was ready to write the check—but there was a hitch. The Naifys, eager to avoid a big tax bite, refused cash. But after several months of negotiations, the Naifys took $150 million in cash and $270 million in debentures, convertible into TCI stock starting in 1988. For just $150 million down, Malone won 65% control of the nation's largest theater chain operator, with 2,200 screens and a 750,000-subscriber cable system. It cost him $1,100 per subscriber, half the going price today.

That deal opened up new opportunities for Malone, especially after Stewart D. Blair, the close associate he put in charge of UA, went off on a modest buying spree of his own. Blair bought theaters with 614 movie screens, an operation that sells mobile radios, and a radio station in Grand Rapids. Blair wants to put together package deals for advertisers and consumers. UA recently set up a team comprising representatives from its cable, theater, and radio operations to study cross-promotion possibilities.

Malone has pretty much stayed on the sidelines this year as record numbers of cable systems have changed hands. He seems crouched to pounce on Storer Communications, whose owner—Kohlberg Kravis Roberts & Co.—is getting ready to entertain bids. Investment banking sources tell BUSINESS WEEK that four big names, including TCI and Time Inc., are considering a joint bid for Storer and its 1.3 million subscribers. The consortium has not yet decided how to handle the acquisition if it goes through. It probably will be left intact to avoid huge tax levies. No decision can be made until the bidders sort through Storer's complex finances and layers of debt. Malone wants Storer but says there's a limit to what he'll spend for it.

**'GODFATHER.'** It's in such situations that Malone's record is worth its weight in cable companies. Small operators know they have a lot to gain by being in the champ's corner. TCI is a minority partner at 35 cable companies, and that entitles its operators to the price discounts that the cable giant has negotiated with program suppliers. Services such as HBO often set rates for TCI that are as much as 30% lower than other cable operators pay. With extra cash to spend, the cable operators can grow more rapidly. They also become intensely loyal to Malone. "He's a sort of Godfather of the industry," says broker J. Patrick Michaels Jr., chairman of Communications Equity Associates in Tampa. "Everybody owes something to John."

Critics use the Godfather analogy, too. With lower program costs, TCI-connected operators can spend more building their own little empires. And when a system is for sale, TCI can outbid competitors who pay more for their programming. Commenting on the advantage TCI gets from the lower price it pays programmers, Frank Biondi, CEO of Viacom, says: "It drives the whole acquisition machine."

When program suppliers try to deny Malone the low rates he wants, he becomes a fierce opponent. ESPN discovered that unhappy fact in 1984 when it tried to raise Malone's rates. Malone threatened to drop the service, a potentially devastating blow. When MTV tried to get a higher price from TCI in 1984, Malone vowed to help Ted Turner start a competing service. Both ESPN and MTV abandoned their efforts to raise rates. And NBC, after months of negotiations with Malone in 1985, decided it wasn't worth the company's while to start its own all-news cable show, when it took a look at the low rates he demanded if he were to carry the channel.

The once-icy relations between operators and programmers are thawing. It's increasingly clear that the cable industry needs more original programming if it hopes to attract new business and compete for more national advertising dollars. Besides the investment in Ted Turner's bailout, Malone has put money in several home-shopping and movie channels as well as in entertainment programming that caters to black audiences. He's urging other operators to join TCI in developing a war chest that will be used to launch a new network-quality channel, possibly using the Turner Broadcasting System as its base. Says John E. Sie, TCI's senior vice-president: "Now that we've shown we can band together, anything's possible."

**OVERRUN?** Malone isn't staring at a television screen while he waits for his fellow cable operators to come up with the cash. He's busy dabbling in newer kinds of cable services. He invested $5 million in X*Press, an information service that provides news, entertainment, and financial data to home-computer users via cable. The service, launched in May on TCI's systems, has 3,300 subscribers, and Malone expects steady growth. Malone owns two-thirds of the enterprise; the remaining third belongs to McGraw-Hill Inc., publisher of BUSINESS WEEK.

Malone has a lot riding on such investments. Without new services cable can be overrun by advances in other technologies such as direct satellite broadcast, which would allow programmers to skip cable operators and beam directly to dish owners. Malone is concerned that new rivals, such as utility and telephone companies, will fight for cable business in well-to-do neighborhoods. Federal restrictions now bar the Baby Bells from cable operations, but the phone companies are fighting to have them lifted.

If they succeed, they still must contend with Malone. His power, brains, and cash have already made him an equal of the networks and Hollywood studios as they wrestle for control of the entertainment business. And those who have seen Malone in action know that it's dangerous to tangle with the king of cable.

*By Mark Ivey in Denver, with Frances Seghers in Washington, Matt Rothman in Pittsburgh, and bureau reports*

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# THE TED TURNER SHOW: SHORTER REINS, BUT A STEADIER RIDE

By most accounts, it has been the worst of times for flamboyant cable industry entrepreneur Ted Turner. In the past two years, he lost a house in a fire, separated from his wife, dropped $26 million on a pseudo Olympics in Moscow, and failed in a bid for CBS Inc. He became the laughingstock of Hollywood, too, for assuming $1.5 billion in debt to buy a library of classic, yet overly worn, MGM movies. And to top it off, Turner was effectively forced this summer to give up control of his Turner Broadcasting System Inc. to a group of cable industry operators led by John C. Malone, president of Tele-Communications Inc.

But what's bad for Turner may yet be good for his TBS empire. With an equity infusion of $562.5 million from the cable community, including industry powerhouses TCI and Time Inc., TBS has been temporarily bailed out of the financial mess created by Turner's overly ambitious purchase of MGM. Even more important, TBS is forging a potentially powerful new alliance with the operators. The new investors will give TBS a built-in market of more than half the 43 million cable-subscribing U. S. homes. "The risks are probably the least in our history," says longtime Turner confidant Terence F. McGuirk, a TBS vice-president.

However, Ted Turner and his new crew of cable operators still must navigate some rough water. TBS has to replace $1.4 billion in debt, much of it pricey junk bonds, with lower-cost capital. If it can't, Turner will be forced next year to give up even more control. The operators, who now hold seven seats on the new 15-member TBS board, or Time, a big investor, could possibly wind up directing TBS.

**OVERNIGHT SENSATION.** Whatever the future holds, right now TBS is doing just fine. Its Cable News Network Inc. continues to add new subscribers, rack up higher revenues and profits, earn praise, and boost ratings. Even ad sales at SuperStation WTBS are outperforming the company's expectations this year. Although analysts think it may be years before TBS sees a profit, losses in the first six months of 1987 narrowed to $65.8 million, an improvement from the $77.1 million lost in the same period last year. And TBS stock, boosted mostly by the investment from the cable operators, has doubled in the last year, to about $13.25.

TBS is laying the groundwork for a cable channel to replace SuperStation WTBS, one which would allow operators to sell local ads. Although it may be difficult to pull off, insiders say it's likely to be a cable channel that would carry many of the classic movies in MGM's library, major sporting events, and original programming. Says McGuirk: "The cable industry is looking for the big-event network."

TBS also is exploring the possibility of adding other channels. Industry sources say TBS is having preliminary discussions about acquiring other basic programmers, such as American Movie Classics, Discovery Channel, or Cable Value Network. TCI's Malone is even toying with the idea of having TBS use the programming expertise of Time's Home Box Office Inc. While TBS may just be looking for ideas, a launching pad, or a base of programs for its new channel, the result could very well be the start of what both Malone and Turner have envisioned as another contender for the title of America's fourth television network.

But if Turner does hop back on the acquisition trail, don't expect a rerun of his fiasco with MGM. New TBS board members vow to rein in the Atlanta cable magnate, who has a tendency to be impractical. While some TBS watchers say that Turner will find it difficult to live with such tight new control, no one is expecting him to exit the cable industry soon. Although Turner may not be the powerful fixture in the industry that he was before, his show at TBS is looking very much as if it's back for a return engagement.

*By Scott Ticer in Atlanta*

EXHIBIT J

RADIO TELEVISION CABLE SATELLITE

Broadcasting Oct 12

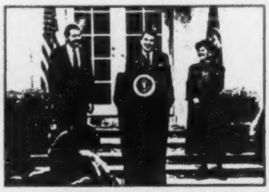
Vol 113 No 15

TOP OF THE WEEK

## Mimi Dawson to leave FCC for Transportation Department

If all goes well, Mimi Weyforth Dawson will go from regulating the broadcasting, cable and telephone industries to regulating the airline, trucking and railroad industries within the next few months.

President Reagan tapped the 43-year-old Republican, who has served on the FCC since July 1981, to become deputy secretary of transportation. Reagan named the current deputy, James H. Burnley (left), to succeed Elizabeth Dole as secretary. Dole resigned last month to help her husband, Senator Robert Dole (R-Kan.), in his run for the Republican presidential nomination.



"I know that Jim and Mimi will push ahead even further on such critical issues as airline safety, privatization of public transportation, space commercialization and industry and general transportation safety," Reagan said at a White House ceremony last Thursday. "And that list represents a tall order for both of them."

The two have not yet been formally nominated, but, once they are, they are expected to win Senate confirmation within a few months. Burnley may have some trouble because he antagonized key members of Congress during his four years as deputy secretary.

Following the announcement, Dawson praised her colleagues, particularly Chairman Dennis Patrick, and said she "would miss them dearly." She acknowledged that her stint at DOT will be a short one—it will last no longer than the Reagan Administration—but that it should not be an uneventful one. "I think a lot of things need to be accomplished. . . . It's not likely to be a sleepy year, believe me."

Dawson's appointment could result in a three-person FCC. The FCC is supposed to comprise five commissioners, but it has been one short since Mark Fowler stepped down as chairman last April. Bradley Holmes, a former aide to Patrick and now head of the FCC's Mass Media Bureau's policy and rules division, has reportedly been tapped to take Fowler's slot, but the White House has yet to nominate him.

According to FCC officials, a three-person FCC is not preferable, but it is workable. Under the FCC charter, three commissioners constitute the quorum necessary to take actions.

Speculation of who would replace Dawson began even as she accepted the President's praise in the White House rose garden before her colleagues, family, friends and a roped-off gang of reporters and television cameras.

Two of the names being mentioned were on the short list for

Continues on page 32

# Turner's TNT adds spark to Atlantic Cable Show

**New basic cable network, planned for March launch, still needs board approval; on the wish list: major sports events including the Olympics, Academy Awards, Grammys, pageants**

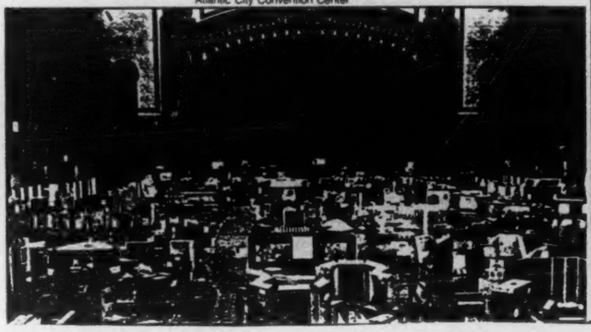
Ted Turner, in a keynote address opening the Atlantic Cable Show, revealed details about his planned basic cable network, Turner Network Television, which he said would be a cable-exclusive program service built around major television events. The service, which needs the approval of the Turner board, which is scheduled to take up the matter at a meeting on Friday, Oct. 16, would be supported by both advertisers and cable operators.

Turner's superstation, WTBS(TV) Atlanta, "has gone about as far as it can go," Turner said. "I need to get subscriber fees so we can go to the next level." The fees he envisions would begin at 10 cents per month per subscriber in March 1988 and would increase to 20 cents in March 1989. He also said the network would carry 10 minutes of advertising an hour, with three to four minutes turned back to the cable operator.

The events Turner wants to go after include Major League Baseball, the National Basketball Association, NCAA basketball, all the college football bowl games and associated parades, the Olympics, the Kentucky Derby, the Daytona 500, the Indianapolis 500, the PGA, U.S. Open golf, the Masters, the British Open, Wimbledon, U.S. Open tennis, Miss USA, Miss Teen USA, Miss Universe, the People's Choice Awards, the American Music Awards, the Kennedy Center Honors, the Academy Awards, the Tony Awards and the Grammys. Turner's Goodwill Games would also appear on the new network.

Turner made it a point to claim that making the new service cable-exclusive was his idea. And he said his legal counsel has advised him that because TNT would be a start-up service, it would not run afoul of antitrust laws. Cable programers have come under

Atlantic City Convention Center



*Continues from page 31*

the seat now tentatively set aside for Holmes—Susan Wing, an attorney at the Washington law firm Hogan & Hartson, and Allen Moore, minority chief of staff of the Senate Commerce Committee.

Also being mentioned last week were Robert Pettit, a former aide to Dawson who is now practicing law at Wiley Rein & Fielding, and Rodney Joyce, a former deputy at the National Information and Telecommunications Administation, who is an attorney with Finley Kumble Wagner Heine Underberg Manley & Casey.

According to one FCC source, Patrick is sitting this one out. Patrick will concentrate on getting Holmes seated, the source said, and avoid politicking for any replacement for Dawson.

There was no word from the White House on Holmes's status last week. But the more time that elapses without a nomination, the more talk there is about a recess appointment, which would give Holmes the seat until the 100th Congress adjourns late next year. Congress is currently expected to recess by Thanksgiving.

If Burnley's attitude toward Congress is confrontational, Dawson's is conciliatory. During her six years at the FCC, she helped assuage congressional concerns over the FCC's deregulatory initiatives. Having spent 12 years working on Capitol Hill, she probably understands Congress better than any other member of the FCC.

Dawson was considered the FCC's expert on common carrier matters. "Some of the other commissioners who didn't follow common carrier in such detail listened to her very carefully," said FCC Commissioner James Quello. "I was among them."

Dawson went along with most the the FCC's deregulatory moves in broadcasting matters, but was more than a follower. When the FCC was liberalizing its multiple ownership rules in 1984, she persuaded the FCC to temper the new rules by placing a cap on on the percentage of homes any one broadcaster may reach.

She did cable a favor by insisting on a five-year sunset on the FCC's new must-carry rules, but she has expressed concerns about the monopoly power of cable systems.

Represenatives of the industries she has regulated had good things to say about her last week.

"We think she has been an extremely good commissioner," said National Association of Broadcasters President Eddie Fritts. "Her views have been fair and balanced. She's always willing to listen and consider our proposals, although she has not always voted with us. She has an expansive view of the communications landscape. We will miss her at the commission."

Said National Cable Television Association President James Mooney: "She has been fair and knowledgeable, and it's hard to ask for any more than that."

Andy Schwartzman, executive director of the Media Access Project, which has resisted many of the FCC's deregulatory efforts, had a considerably different view. "We wish her well," he said. "But if she does for air travelers what she has done to TV and telephones, we will all be stacked up over Chicago at first-class fares."

Speculation that Dawson would leave the FCC for a higher government post has waxed and waned ever since Dennis Patrick beat her out last January to succeed Mark Fowler as FCC chairman (BROADCASTING, Jan. 26).

Dawson has some valuable Washington connections. Between 1973 and 1981, she was an aide, and at the end chief of staff, to Senator Robert Packwood (R-Ore.), who helped get her the FCC seat in 1981. "The senator was spectacular. He went to bat for me", she said in a 1984 interview. Packwood also pushed her for the chairmanship in 1986.

Her husband, Rhett B. Dawson, the former staff director of the Senate Armed Services Committee, has worked in the White House since April as the assistant to the President for operations, overseeing the offices of staff secretary, administration and military (BROADCASTING, April 6).

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fire from noncable constituencies that claim they are not getting a fair chance to obtain cable programing.

The new service would premiere in March with an exclusive showing of "Gone with the Wind," which Turner bought with the MGM film library. Turner said he hoped the service would present original dramatic programing in addition to the major events. To fill the void on Turner's superstation, WTBS(TV) Atlanta, once the sports programing moves over, more movies would be scheduled, he said. As to where operators could find room on crowded systems for the new service, Turner said: "You'll have to make room where you can."

In his speech, Turner said the cable industry needed to improve in four functions to move ahead. He said cable has adequately covered niche programing. It now needs to develop "dramatic first-run programing that competes with the networks." Second, the cable industry is "way behind in [its] ability to promote." Third, penetration should reach 70% in the next five to seven years, "an achievable goal." And fourth, cable needs to "dramatically improve its share of advertising dollars." He said television broadcasting had a five to one advantage over cable in ratings but a 10 to one advantage in ad billings. He said advertisers are playing the basic cable networks against one another, and inventories need to be constricted to increase rates. He saw no reason why cable cannot get 30% to 40% of local TV sales in the future.

Turner said the "industry shouldn't compromise away things that are important to consumers," referring to action in Washington that would reinstitute syndicated exclusivity. Broadcasters and Hollywood, as chief proponents of reinstitution, are "doing it for their own selfish interests," he said, and not for the benefit of the public. He also said he was not happy with the must-carry compromise, although he did not challenge the latest set of rules. But he said they were still discriminatory. "I never asked for must carry for CNN," he said. Automatic carriage "is not their God-given right." □

Turner

## Broadband's Kahn plans fiber optic overbuild on NYT Cable system in Southern New Jersey

Irving Kahn wants to put a little fiber into cable's diet.

To prove that fiber optics is an economical, reliable alternative to conventional coaxial technology, the chairman of Broadband Communications plans to build a fiber optics cable system in southern New Jersey which is already served by cable installations belonging to the *New York Times*. Kahn, who sold the *Times* the system that he now intends to overbuild, revealed his plans at the Community Antenna Television Association open forum during last week's Atlantic Cable Show.

A long-time supporter of fiber optic technology, Kahn said he decided to "put into practice today what we've been yelling about for a long time." Kahn hopes to have a full-scale cable staff on board in 60 to 90 days and to explore the feasibility of establishing fiber optic systems in other parts of the state and the country.

Kahn believes that declining prices of fiber optic technology make it just as feasible to install fiber optics as to build a 550 mhz coaxial cable plant.

Kahn said fiber optic costs are running five cents a foot. He predicted that with increased use of fiber optics in the next few years systems could be built for $500 per home. Maintenance costs of fiber optics are much lower than that of coaxial, he asserted.

Kahn said one key benefit of fiber optics is its ability to provide greatly expanded channel capacity, which he said would give cable an opportunity to "become the local soapbox in the community." Fiber optics would allow cable operators to program 100 channels while using only 25% of the system's capacity.

Systems could use such capacity for such services as electronic mail, which Kahn said have been largely ignored by the cable industry. He predicted that the "downtown revenue" could one day equal the revenue from all of the entertainment services.

Expanded channel capacity could more easily accommodate high-definition television, which Kahn believes needs 12 to 18 mhz of bandwidth. Stereo television could also be more easily implemented with fiber optics.

Fiber optics could also provide homeowners with gas, electric and water meter readings, he said.

To carry out his plans for fiber optics, Kahn is applying for franchises in areas where NYT Cable operates. (Kahn built the original system of 35 channels and two-way interactive services in 1967. He sold it to the Times company in the early 1980's. His consultancy and noncompete agreement with the company expired last March.)

Kahn said he chose the NTY system because of the low channel utilization and his belief that there should be more subscribers and more homes taking interactive pay-per-view services. (Roughly half of the NYT system is equipped with Sprucer interactive technology.)

"If the existing cable operator has done his job, that's not the system that can be easily overbuilt," he said. But the key, he added, was fiber optics. If a 550 mhz coax is overbuilt by a 300 mhz coax, he said, "everybody is going to lose."

Although his initial system will be a hybrid of fiber optics and coaxial, he has plans for the entire system eventually to be constructed with fiber optics. Initial financing will be his own, Kahn said, adding that he does not plan to bring in outside investors until the system is proved.

Kahn also warned cable operators about competition from direct broadcast satellites and telephone and electrical utilities. A number of phone companies already have moved heavily into fiber optics. "Very frankly, it's almost too late," for cable to get into fiber, he said. At the same time he predicted dire consequences if it did not. "If you don't understand your possible competitors, you're doomed," Kahn said.

He believes the telephone companies have refined technology so that fiber optics is easier to split in the field and is cheaper to repair. Except for a smattering of efforts by a number of operators, American Television & Communications is the only player that is making a major push with fiber optic technology.

ATC is developing a system of using fiber optics from headend to fiber nodes, where it would be integrated with the existing coaxial plant that carries channels into the home. ATC hopes to have a laboratory demonstration model within the next six months and hopes to roll out the technology to its systems within the next one to three years. ATC's Kansas City system has been targeted for the initial implementation.

The key to ATC's fiber optics plans, said James Chiddix, vice president, engineering, ATC, is that it reduces significantly the number of amplification points in a system. ATC will overlay its existing coaxial plant, said Chiddix, but only a fraction of the system would be fiber optics. Applying what ATC is developing to its Honolulu system, Chiddix said only 100 to 200 miles of the 1,600 miles of plant would be a fiber optic overlay. ATC hopes the expense of fiber node electronics can be reduced to the point that fiber optic plant could get within one-half of a mile of the home.

Kahn

ATC, for now, sees no need to extend fiber optics technology all the way into the home. Chiddix said coaxial is more compatible with existing consumer electronics, is already in place and, with fiber optics delivery more and better signals to node points, "a very good broadband pathway" capable of handling expanded channel capacity for such services as HDTV.

## Cable and broadcasters at odds over Bryant repositioning bill

The Atlantic Cable Show served as the first open forum for debate on the channel repositioning bill introduced by Representative John Bryant (D-Tex.), with cable officials roundly denouncing the bill and broadcast lobbyists describing it as necessary because of continued channel changes by cable operators.

The bill, which picked up the endorsement of the Motion Picture Association of America last week (see page 79), would grant local officials the power to mediate disputes over channel realignments. John Summers, senior executive vice president, National Association of Broadcasters, said the bill was needed "based on immediate past history," of channel changes by cable operators. Broadcasters spend hundreds of thousands of dollars on channel promotion, which he said can "go down the drain overnight" if a cable operator moves a broadcaster from his FCC-assigned location to another channel.

James Mooney, president of the National Cable Television Association, countered by asking whether Summers was comfortable with local governments, which may come under the investigative scrutiny of local television broadcasters, deciding where their channels should be placed. What, asked Mooney, prevents a mayor from moving a VHF affiliate to a much higher channel position, because he has a grudge against the station? Summers said he assumed the local cable official, and not the mayor, would be making that decision, and the situation Mooney described was a worst-case scenario. "I don't see any other resolution to that problem," Summers said, in referring to the Bryant bill. The FCC is unlikely to do anything about the problem, he said, but he acknowledged that legislation is probably a long shot.

Shaun Sheehan, vice president, Tribune Broadcasting, told the cable operators that "the solution in great part is in your hands." He emphasized the importance to Tribune of channel assignments that reflect the broadcast dial. "It's important to us to come up on channel 11," he said, referring to Tribune's WPIX(TV) New York.

Bert Carp, vice president for government affairs, Turner Broadcasting, said the broadcasters' position on the bill threatens the improved relations between the industries. He called the Bryant bill "a very ugly episode." In referring to his boss who successfully challenged the must-carry rules, Carp said, it will be "tougher for Ted to pull back when the next compromise is reached" because of broadcasters' support for the bill. He also said the legislation is a UHF bill to keep the competitive advantage UHF obtained when carried on VHF channels on cable systems.

Summers retorted that the bill doesn't violate the provisions of the must-carry compromise. "All it says," he said, is that disputes must be worked out on the local level. It doesn't mean a mandate for broadcasters to be on-channel, he said. But of concern to some cable operators in the audience were the number of jurisdictions that could be involved in alignment questions. NYT Cable's system in southern New Jersey, it was pointed out, has 55 different franchise authorities, all of which could be involved in a challenged channel shift. It could be a bureaucratic nightmare.

The Bryant bill got another airing the next day, when Preston Padden, president of the Association of Independent Television Stations, and Michael Soper, senior vice president, development, Public Broadcasting Service, squared off against Stephen Effros, president of the Community Antenna Television Association, and Gerry Lenfest, president of the Lenfest Group.

Padden said the bill was a "reasonable and moderate" solution to a problem that, despite publicity, has not gone away. "My phones are ringing off the hook," he said, from members with channel repositioning horror stories. In many instances, he charged, shifts were made without notice and during crucial ratings periods. He also said in many instances second sets in the home are not cable ready, so if an independent has been moved above channel 13, it cannot be viewed. The ratings that independents are getting under the peoplemeter, 24% of the total audience, according to Padden, prove that consumers like independent programing and that cable operators should not move channels thinking that only small audiences are involved.

Soper said the 152 reported shifts of public broadcasting stations in 1987 has affected 44% of all public stations. "We're worried about the trend," he said, in explaining public broadcasting's support of the Bryant bill. All the panelists agreed with one point made by Soper: that lack of communication has helped to exacerbate the situation. (Indeed, public broadcasters from New York and New Jersey took out an exhibit booth at the Atlantic show to explain their side of the repositioning question [see page 83].)

Effros, in raising many of the points Mooney had raised, was blunt about the legislation. It is unconstitutional, he said, and "the stupidest idea the broadcasters have ever come up with." He questioned whether broadcasters understood the First Amendment applications of local governments deciding channel alignments. When affiliation changes have taken place in a market, he said, viewers were able to find the programing they wanted to watch without government help.

Lenfest said his systems, serving over 240,000 subscribers, had not moved any stations and it was his view the problem was "more imaginative than real." There are occasions where channel shifts are justified, but over all, he said, "any changes create all sorts of headaches." His advice was to leave the VHF's where they are and keep as many UHF's as possible on their on-channel assignments.

Lenfest called for regional cooperation between broadcasters and cable operators and also thought it would be valuable if both sides could agree upon guidelines on where channels should go. Padden responded that no single plan would solve the problem, saying "it is our hope to work it out on a local basis."

Mooney and company also discussed must carry and syndicated exclusivity. Summers said he hoped the must-carry rules would survive court review but if they did not, an open marketplace would result. If that happened, he said, the compulsory license would be eliminated soon afterward. He also doubted whether the cable industry could be pulled together for another crack at the rules and speculated that "maybe Jack Valenti [president of the Motion Picture Association of America] will be the winner" when the dust settles. But Summers did not believe the local portion of the compulsory license would be thrown out. "There are very pragmatic people on the Hill," he said. And it is in the best interest of broadcasters and cable operators, he said, "to preserve the compulsory license for carriage of local signals."

Carp said the defenders of the rules have their work cut out for them, and he doubted whether they could succeed. As for what happens if the rules are struck down, he hoped that "interindustry bitterness" could be avoided, but with broadcasters' support of the Bryant bill, "I just don't know."

Carp saw the FCC's consideration of revival of syndicated exclusivity as "a solution seeking a problem." He said it would be "bad consumer relations" due to the "enormous disruption" in schedules that would result.

Summers said broadcasters have always supported program exclusivity and saw an opportunity to bring back the rules when Dennis Patrick became FCC chairman. He said the Ferris commission went too far in throwing out the rules in 1980. Mooney asked Summers what would happen if reinstitution of the rules caused Hollywood to increase program prices. Summers said that was a possible scenario, but that broadcasters could handle that situation.

Summers's personal view was that syndex would be adopted but challenged in court. At that point, he said, maybe cable and Hollywood would get together and solve their copyright problem, which spills over into the program exclusivity debate.

## Cable executives, mindful of phone companies and reregulation, say industry needs to concentrate on programing, marketing and technology

Top executives from three MSO's plus one independent operator identified programing, marketing and technology as the key driving forces cable needs to stay a step ahead of future competition. The biggest hazards cable faces, the Atlantic Cable Show participants said, are reregulation, intrusion by phone companies, a revival of syndicated exclusivity for broadcast carriage and failure, as an industry, to live up to its promises.

James Cownie, president of Heritage Communications and chairman of the National Cable Television Association, said "we have a lot of ground to defend." He said cable needs adequate channel capacity to offer the new services coming on board and in development. That will stand the industry "in good stead," Cownie said, against DBS, telcos and overbuild competition. He also urged operators "to embrace the new program services" and "develop cable-exclusive programing" which, he said, is a source of protection against competition. Customer service also needs work, he said. Cownie's biggest concern was direct and indirect competition from telephone companies. "Cross-subsidization is something we can't tolerate," he said.

Kenneth Bagwell, president, Storer Cable, urged improvements in marketing, technology and advertising sales. He also said cable should capitalize on high-definition television which "is going to come a little faster than we think." He called local advertising "the most underrated source of revenue." He said cable operators ought to have the courage to turn business down in order to squeeze inventory and increase prices. Storer, he said, has separated cable ad sales from the cable operation itself, preferring to let ex-broadcast sales personnel handle cable ad sales. Bagwell urged cable operators to be careful how they conduct themselves. "I fear most reregulation," Bagwell said.

Charles Dolan, chairman of Cablevision Systems, said the driving force in the cable industry will be the "increase in skill and energy with which we perform the basic tasks of our services." He identified those as service, programing and marketing. Dolan said Cablevision was improving service with greater feedback from customer service representatives, intersystem competitions to increase penetration and improved installation task force training. He said cable operators need the subscriber to say: "I cannot get along without cable." Dolan saw no future threats, only challenges. The one menace, he said, "was failing to do everything we could do."

Joe Gans, president, Cable TV Co., argued for greater commitment to technology and urged operators to support the creation of a cable technology laboratory. "We've gone flat," Gans said. "We could have done HDTV eight to 10 years ago."

Scrambling also should have been done years ago, he said: "Somebody has to take the leadership. The bottom line," Gans said, "is that technology made this industry." Gans also was fearful of the costs to smaller operators if syndex is reinstituted and operators are forced to drop segments of programing and insert others.

On overbuilds, Cownie said, cable operators will have to build areas with lower homes-per-mile ratios than in the past. Bagwell blasted the greenmail and cherrypicking overbuilds, but said he had no sympathy for operators who provide few channels and poor service and are overbuilt. Dolan said cable should take "a very open" attitude toward competition, wherever it may arise. ☐

## *Fairness imbroglio*

As anticipated, House passage of an FCC authorization measure (H.R. 2961) stalled last week in a dispute over Democrats' attempt to inject in an accompanying committee report a criticism of the FCC's repeal of its fairness doctrine. Commerce Committee members came to a standoff over the draft of the report a week earlier ("In Brief," Oct. 5). The Democratic criticism of the FCC's action caught Republicans by surprise, but by late last week they reportedly succeeded in excluding the language. The report was to be filed late last Friday (Oct. 9) and was said to contain no mention of fairness. The bill could come up for action this week.

Originally the report was said to "debunk" the FCC's justification for elimination of the doctrine and to instruct the FCC not to participate in any judicial appeal if the doctrine is codified by Congress. Committee reports are not binding, and it is unclear what effect the fairness section would have had on the FCC. The bill's primary purpose is to establish funding levels for the agency in fiscal year 1988-89.

EXHIBIT K

FOX, WEINBERG & BENNETT
1714 MASSACHUSETTS AVENUE, N. W.
WASHINGTON, D. C. 20036

NICHOLAS W ALLARD

TELEPHONE: 202-778-[illegible]
TELECOPIER: 202-778-2330

RECEIVED
MAR 4 '88

March 4, 1988

Hand-Delivered, Return Receipt Requested

Mr. H. Walker Feaster
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Room 222
Washington, D. C. 50554

RE: Transfer of Control of Earth Stations Licenses WK42, E7990 -- Your Reference #039-DSE-TC-88(2) and License E4599 -- Your Reference #1038-DSE-TC-88

Dear Mr. Feaster:

Enclosed are the original and five copies of the Wireless Cable Association's comments on the application for transfer of control of Tempo Enterprises' FCC licenses, which are referenced above.

I would be happy to respond, should you require any additional information.

Sincerely,

Nicholas W. Allard

Nicholas W. Allard

NWA/rd
Enclosures (6)
cc: Curt Bradley
James M. Theroux

## WIRELESS CABLE ASSOCIATION COMMENTS ON THE APPLICATION FOR TRANSFER OF CONTROL OF TEMPO ENTERPRISES' FCC LICENSES

In connection with the acquisition of Tempo Enterprises, Inc. ("Tempo") by Tele-Communications, Inc. ("TCI"), applications have been filed for the transfer of control of the licensees of earth stations WK42, E7990, and E4599. The licensee of common carrier satellite uplink Earth Stations WK42 and E7990 is Southern Satellite Systems, Inc. ("Southern Satellite"), a wholly-owned Tempo subsidiary. Southern Satellite is in the business of retransmitting television broadcast Station WTBS, Channel 17, Atlanta, Georgia to approximately 41.6 million cable television subscribers. The licensee of satellite transmit Earth Station E4599 is Tempo Television, Inc. ("Tempo TV"), a 99.2%-owned Tempo subsidiary. Tempo TV is in the business of providing originated television programming to approximately 12.5 million cable television subscribers. TCI, which would assume control over these two licensees, is the nation's largest cable television operator, with control of or interests in approximately 8 million subscribers.

The Wireless Cable Association is highly concerned about the potential repercussions of the transfer of control of these two licensees. While such a transfer may raise numerous communications policy issues, these comments will focus on its effect on competition in the retail market for satellite-delivered programming. This transfer represents a vertical integration that will put the nation's largest cable operator in control of two of the nation's most important sources of satellite-delivered programming. The wireless cable industry has been restrained from competition with cable operators due to its inability to obtain satellite-delivered programming. Wireless Cable's view is that programmers refuse to deal with wireless cable (1) if they are leery of alienating cable firms or (2) if the programmers are owned in whole or in part by cable. The refusals to deal bolster cable's power in the market for the delivery of satellite programming to the degree that if the transferee of these two licensees adheres to the typical pattern and the subject programming is not offered to competitors of cable such as wireless cable, then the competition in the delivery of satellite television programming to consumers will be gravely diminished. Wireless Cable asks that TCI respond by stating its intention to make the subject programming freely available to distributors such as wireless cable firms.

A. The Wireless Cable Industry

The wireless cable industry consists primarily of firms possessing FCC authorization (or leasing capacity) to deliver programming received from satellites and retransmitted on microwave frequencies to small antennas on individual homes.1/ Currently, wireless cable firms are

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1/ The Wireless Cable Association is a trade association of firms and individuals that are providing or intend to participate in the retail distribution of programming through one or a combination of the following services: Multipoint Distribution Service ("MDS"), Multichannel Multipoint Distribution Service ("MMDS"), Instructional Television Fixed Service ("ITFS"), and Operational operating in Cleveland, Detroit and New York, among other places. Many entrepreneurs are attempting to bring wireless cable to other markets but have been hindered in both their attempts to secure funding and to start their businesses by the lack of assurances of programming availability.

Wireless cable firms typically can deliver satellite television programming[2] to homes at lower costs than those incurred by cable franchisees. The principal reason is that cable wiring expenses are high and cable must wire an entire street to deliver programming to any individual home on a street. Wireless cable's fixed costs are smaller, and the marginal costs of each new subscriber -- the costs of installing an antenna on a particular home -- are less than the pass-by charges incurred by cable.

## B. The Denial of Programming to Wireless Cable

Many programmers are refusing to deal with wireless cable.[3] The programmers' stated reasons include the view

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Fixed Service ("OFS"). It also includes many others involved or potentially involved in this business, such as antenna and other equipment suppliers.

[2] Satellite programming includes news (including weather, financial, sports, local, and general), sports (both regional and national), variety shows, movies, and shopping.

[3] Cable franchisees typically market a basic service to their customers of 12 to 36 channels of programming, including local broadcasts. Generally, customers can also subscribe to one or more premium services, such as movies. Most cable and wireless cable firms believe that in order to attract subscribers it is necessary to provide at least the major premium services and certain preferred aspects of the basic package, such as live sports and continuous news.

that wireless cable firms are not well run; the claim that wireless cable technology delivers a poor signal and is subject to theft; and the contention that future market penetration of such programming should be entrusted to cable. None of these alleged reasons has a sound factual basis. Wireless Cable has reason to believe, based on private conversations with programmers, that the programmers' motivation for refusing to deal is their unwillingness to alienate cable.

Moreover, two years of operating experience by the Cleveland wireless cable system reflects the spuriousness of any criticism of the technology of wireless cable. The marketplace is an efficient mechanism for sorting the merits of various technologies, assuming it is permitted to function freely. The fact is that programmers and cable operators have stymied the development of numerous other alternative technologies, such as DBS, backyard dishes, and Ku-band satellites.4/ Finally, programmers and cable operators have aimed their efforts towards preventing the development of "overbuilds" for cable, i.e., "second franchises" that use the cable technology.5/ This demonstrates that established cable franchisees oppose not only alternate delivery

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4/ See e.g., Cable in Lead in Hill Home Dish Fight, Broadcasting, Sept. 29, 1986, at 31 (cable opposing Gore bill to make programming available to backyard dish owners).

5/ See, e.g., Shooshan, Cable's Changing Tune on Competition, Cablevision, Feb. 1, 1988, at 15 (cable industry "seeks program exclusivity for itself against SMATV, MMDS, DBS and competing cable systems").

technologies (regardless of their engineering merits) but any competitive retailer of satellite programming.

In reality, the inability of wireless cable to obtain programming is the result of exclusive dealing arrangements between cable operators and programmers, and vertical integration between cable and programmers pursuant to which the acquired programmer refuses to deal with wireless cable. Individual cable franchisees are local monopolies[6/] that have enormous national power when acting in concert. TCI is the most salient example.[7/] In some instances, cable franchisees demand exclusive contracts by which programmers agree not to make their product available to competitors of cable. In other instances the cable operators are indulged by programmers who refuse to deal with wireless cable firms. In still other instances programmers will sell to wireless cable firms only if the firms promise not to distribute the programming in competition with cable.

Finally, even when programmers do offer their wares to wireless cable, they typically charge discriminatorily high prices, for no apparent reason other than, probably, a desire to please cable. All these practices have the effect of restraining competition at the retail level between cable

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[6/] See Central Telecommunications, Inc. v. TCI Cablevision, Inc., 800 F.2d 711 (8th Cir. 1986), cert. denied, 107 S. Ct. 1358 (1987).

[7/] See The King of Cable TV, Business Week, Oct. 26, 1987, at 88 (head of TCI is "possibly the most powerful man in television" -- not only cable). TCI's cash flow is expected to hit $1 billion in 1988, Multichannel News, Feb. 29, 1988, at 1.

operators and competitors such as wireless cable. The biggest losers are the consumers. As a result, the United States Senate has begun to express its concern over the denial of access to programming. Senator John Kerry recently noted that "efforts to promote one method or kind of retail distribution [of satellite-delivered programming] over another . . . can frustrate competition and ultimately harm consumers."[8/]

The ultimate weapon for cable operators to preclude retail competition is the acquisition of preferred programming for the purpose of exclusively distributing it through cable. This weapon has been used with increasing frequency. There are approximately 80 different satellite television programming services in existence, and more than half of such services are owned in whole or in part by cable. Indeed, even as the number of programming services has burgeoned, the pace of vertical integration has increased, so that cable's ownership percentage has remained constant during the last several years. TCI, the largest cable operator in the country, already holds equity interests in the following programming sources: WTBS, CNN, and Headline

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[8/] Letter from Hon. John Kerry to Michael Fuchs, Chairman, Home Box Office, Inc. (Feb. 11, 1988) (attached hereto), requesting information regarding exclusive dealing arrangements. Senator Kerry states that such arrangements raise "fundamental antitrust and communication policy issues," particularly, "in light of recent reports by the National League of Cities and the National Cable Television Association of significant increases in the price of basic service in a deregulated cable market."

News, all owned by Turner Broadcasting System (14.16%); Cable Value Network (20%); American Movie Classics (50%); Black Entertainment TV (16%); Event TV (10%); Discovery (14%); and Fashion Channel (10.5%). As one senior cable executive put it, the denial of access to programming creates "real potential public policy problems."[9]

The anticompetitive potential of vertical integration is exemplified by the recent case of New York Citizens Committee on Cable TV v. Manhattan Cable TV, Inc.,[10] involving cable television services in lower Manhattan. The defendant, Manhattan Cable TV, Inc. ("MCTV") has a cable franchise agreement with New York City. While the agreement itself is not exclusive, no other company has a franchise. MCTV is owned by Time, Inc. It offers 31 channels as its basic service and three premium services, two of which (HBO and Cinemax) are owned by Time. The plaintiff, a citizens group, charged MCTV and Time with monopolizing the market for pay cable movie and non-sports entertainment programming service in lower Manhattan, in violation of Section 2 of the Sherman Act. This charge was based primarily on the allegation that Showtime, the Movie Channel, and Bravo had all unsuccessfully sought channel access from MCTV.

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[9] Vertical Integration: The Business Behind the Boom in Cable Programming, Broadcasting, Nov. 23, 1987 at 40, 68. With respect to some of these sources, TCI may have the opportunity to acquire more equity: up to 25.66% of Turner Broadcasting System, and up to 14% of QVC. See id. at 42. Indeed, Ted Turner has conceded that cable operators led by TCI have de facto control over Turner Broadcasting System. Turner Talking TNT, Broadcasting, Feb. 29, 1988, at 40.

[10] 651 F. Supp. 802 (S.D.N.Y. 1986).

The plaintiff sought injunctive relief making channel capacity available to pay cable programmers unaffiliated with Time. The case ended in settlement when MCTV agreed to make available to its subscribers a single additional pay programming service not affiliated with Time, and to introduce one or more additional non-affiliated pay programming services when it upgraded its system in the future.11/

Just as a vertically integrated cable company can deny channel access to programmers in competition with programmers it owns, it can deny programming to retail distributors in competition with its cable services. If TCI acquires control of Southern Satellite and Tempo TV, it might refuse to make WTBS and Tempo programming available to wireless cable at a fair price in those areas where wireless cable is in direct competition with a cable operator (which might or might not be owned by TCI). Indeed, one programmer that is partially owned by TCI, the Fashion Channel (10.5%), has instituted a policy of distributing its programming only to cable. The possibility of such a restriction of competition at the retail level with respect to Southern Satellite and Tempo TV as well is particularly troubling due

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11/ New York Citizens Committee On Cable TV v. Manhattan Cable TV, Inc., No. 86 Civ. 0859 (RSW) (S.D.N.Y. Dec. 2, 1987).

to the very significant nature of the programming provided by these two licensees, and TCI's history of anticompetitive behavior.

### C. The Importance of WTBS and Tempo TV as Sources of Programming

Southern Satellite and Tempo TV are extremely important sources of satellite-delivered programming. Southern Satellite is the only company that presently retransmits WTBS, which has the second largest number of subscribers for satellite television programming in the United States. This programming is on the short list of services preferred by every retailer of programming. It would be very difficult for a retailer to compete without such programming -- just as, for example, a grocery store could not complete without milk and eggs to sell. Obviously, if TCI denied wireless cable access to WTBS programming, the injury to wireless cable would be severe.[12/]

Tempo TV is also a significant source of programming. Besides the fact that it already has 12.5 million subscribers, it is widely anticipated that "Tempo TV could serve another purpose: a launch platform for Turner Network Television (TNT)."[13/] TCI is interested in starting a new network-quality satellite-delivered channel, as is

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[12/] Southern Satellite currently operates as a common carrier and, as such, apparently makes WTBS programming available to all retail distributors. See Tempo Deal Expands TCI Reach, Cablevision, Nov. 23, 1987, at 12.

[13/] A Dynamite Tempo For TCI, Cable TV Programming, Nov. 30, 1987 at 4. See also Tempo Deal Expands TCI Reach, Cablevision, Nov. 23, 1987, at 12.

Turner Broadcasting System.[14] TCI and Turner could build such a channel by starting from the existing Tempo TV subscriber base. While Tempo TV has previously been available to wireless cable, Turner has explicitly proposed making TNT a cable-exclusive service.[15] If TCI denied wireless cable access to TNT, the anticompetitive effect would be even greater than a denial of access to the existing Tempo TV.

### D. TCI's History of Anticompetitive Behavior

While it is disturbing to see any major source of programming fall under the control of cable operators, with the resulting potential for denial of access to wireless cable, it is particularly troubling to consider that these two sources could be controlled by a company with a history of anticompetitive behavior. In *Central Tele-Communications, Inc. v. TCI Cablevision, Inc.*,[16] TCI was found to have violated the federal antitrust laws in taking illegal anticompetitive actions to preserve its monopoly over the Jefferson City, Missouri cable television market. TCI was assessed $35.8 million in damages. The Jefferson City case may not be an isolated incident. For example, in *H.R.M.*,

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[14] *The King of Cable TV*, Business Week, Oct. 26, 1987, at 88, 96.

[15] *Turner's TNT Adds Sparks to Atlantic Cable Show*, Broadcasting, Oct. 12, 1987, at 31.

[16] 800 F.2d 711 (8th Cir. 1986), *cert. denied*, 107 S. Ct. 1358 (1987).

Inc. v. Tele-Communications, Inc.,[17] TCI has been accused of violating the federal antitrust laws in connection with cable television services in Kearney, Nebraska.

TCI's anticompetitive behavior does not appear to be limited to the context of local cable franchisees. TCI has been accused repeatedly of reducing competition at the national level in the programming context.

> The [Motion Picture Association of America] has charged that TCI extracts "monopsony" rents from cable programmers and that it has acted as a "bottleneck" to the introduction of new programming services. Monopsony is buying power -- the opposite of monopoly, which is selling power . . . Indeed, at least a few economists view TCI's situation as posing potential problems.[18]

## E. Conclusion

The pending applications for transfer of control of Southern Satellite and Tempo TV raise serious public policy problems, which will be exacerbated if TCI continues to pursue its apparent business plans. The FCC should consider whether there is a way to assure that such vertical integration will not lead to a denial of access to programming for retail competitors of TCI such as wireless cable. Specifically, TCI should provide assurances that it will sell all its wholly or partly acquired programming to wireless cable firms at non-discriminatory prices.

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[17] 653 F. Supp. 645 (D. Colo. 1987)

[18] Kahn, Concentration and Power in Cable TV: U.S. Seen Unlikely to Intervene Now, Cablevision, May 18, 1987, at 86, 92-94.

Dated: March 4, 1988

Respectfully submitted,

WIRELESS CABLE ASSOCIATION

By: James M Theroux /pd
James M. Theroux
Chairman, Regulatory
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DANIEL K. INOUYE, HAWAII
WENDELL H. FORD, KENTUCKY
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JOHN F. KERRY, MASSACHUSETTS
JOHN B. BREAUX, LOUISIANA
BROCK ADAMS, WASHINGTON

JOHN C. DANFORTH, MISSOURI
BOB PACKWOOD, OREGON
NANCY LANDON KASSEBAUM, KANSAS
LARRY PRESSLER, SOUTH DAKOTA
TED STEVENS, ALASKA
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PAUL S. TRIBLE, JR., VIRGINIA
PETE WILSON, CALIFORNIA
JOHN McCAIN, ARIZONA

RALPH B. EVERETT, CHIEF COUNSEL AND STAFF DIRECTOR
W. ALLEN MOORE, MINORITY CHIEF OF STAFF

United States Senate
COMMITTEE ON COMMERCE, SCIENCE,
AND TRANSPORTATION
WASHINGTON, DC 20510

February 11, 1988

Mr. Michael Fuchs, Chairman
Home Box Office, Inc.
1100 Avenue of the Americas
New York, New York 10036

Dear Mr. Fuchs:

I am writing to you with a number of questions I have about Home Box Office, Inc.'s offer of "wireline exclusivity" to cable systems and multiple system operators (MSO's) which carry HBO's programming. As a member of the Communications Subcommittee of the Senate Commerce Committee, I have been particularly interested in competition in the developing market for satellite-delivered television programming.

HBO'S wireline exclusivity proposal has been dubbed "overbuild protection" in the trade press and described by some consumer advocates as "monopoly maintenance" based on concerns over its potential impact on home viewers. The wireline exclusivity proposal is also opposed by smaller or independent cable systems which are providing -- or plan -- competitive service in communities currently served by only one cable television system. Non-cable distributors may see this proposal as just another effort, this time directed at part of the cable industry, to deny access to programming that is necessary to compete with the established cable system in franchise areas. I understand that HBO has undertaken other exclusivity arrangements, as evidenced by reports, for example, that HBO is offering to make cable operators exclusive KU-band satellite distributors within their service areas.

HBO is, of course, not the only programmer engaged in activities which raise such fundamental antitrust and communication policy issues, and I am well aware that HBO is affiliated with one of the major cable MSO's, American Television & Communications Corporation (ATC), through its mutual parent Time, Inc. While your corporate parent may not wish to have competitors use HBO to compete in ATC's own franchise areas, your policy as announced, does not seem to be limited to just such franchise areas. I am troubled by the appearance that HBO may be involved in efforts to promote one method or kind of retail distribution over another, efforts which can frustrate competition and ultimately harm consumers. Accordingly, I would appreciate your response to the following questions:

1. What benefits do home viewers derive from arrangements such as HBO's wireline exclusivity proposal, and what will it cost them?

2. Would the 25 cents per subscriber fee, apparently to be charged by HBO for exclusivity be collected "up front" when a cable operator agrees to purchase one of HBO's services, or would this fee only be collected in the event an overbuilder competes or threatens to compete with the existing cable operator within a franchise area?

3. Is HBO's wireline exclusivity proposal a policy developed by or directed by HBO's parent company or cable affiliate to advance its own interest?

4. If the wireline exclusivity proposal is not really a strategy developed or directed by HBO's parent company or cable affiliate, why is it not in HBO's interest, and also why is it not in the home viewer's interest, for HBO to promote competition among different retail distributors of its programming, including cable distributors, such as wireless cable, SMATV, and DBS?

5. To what extent do exclusivity arrangements, such as HBO's wireline exclusivity proposal, effectively limit the number of households that HBO can reach, increase prices, and impede competition among those distributors seeking to sell satellite-delivered programming within any local market?

6. To what extent is HBO's programming available now at fair terms and conditions, and will be available in the future, to cable overbuilders and any non-cable distributors who seek to compete with cable distributors for whom HBO is or will be available?

I am particularly interested in your response in light of recent reports by the National League of Cities and the National Cable Television Association of significant price increases in the price of basic service in a deregulated cable market. As you know, Consumer Reports has quantified consumer dissatisfaction with existing cable services. These issues are similar to those raised late last year when the Committee considered S. 889, the Satellite TV Fair Marketing Act. During the Senate Commerce Committee's consideration of that measure, I raised the question of whether there is fair and adequate competition among alternative distributors and technological means of delivering such programming to home viewers. I will be grateful for your assistance in examining this subject as I prepare for further Senate action on S. 889 and related legislation this Spring.

I look forward to hearing from you.

Sincerely,

John Kerry
United States Senate

cc: Hon. Ernest F. Hollings
Hon. Daniel K. Inouye

James P. Mooney, President,
National Cable TV Association (NCTA)

EXHIBIT L

Multichannel Ne

The Newspaper of the Changing Television Industry

# BO Offers MSOs verbuild Protection

By Lee Luchter and Thomas P. Southwick

EW YORK CITY—Home ox Office Inc. last week began fering multiple systems opera-ers the chance to gain "wireline exclusivity" in the residential distribution of HBO services, said company vice president of corporate affairs David Pritchard.

The new policy essentially means overbuilders seeking to build a second cable system in an area would not be able to offer HBO services if the existing operator is covered by the HBO exclusivity contract. HBO runs three premium services: Home Box Office, Cinemax and Festival.

The policy would not prevent multichannel multipoint distribution services, private cable systems, or direct broadcast satellite services from offering HBO services in areas served by covered cable systems.

To gain "wireline exclusivity," Mr. Pritchard said, multiple systems operators would have to meet certain performance standards such as participation in HBO marketing campaigns and extension of penetration by HBO services in the covered systems. Those performance standards would vary from company to company.

In addition, participating operators would be required to pay an additional fee of 25 cents per subscriber per month for each HBO service covered.

Mr. Pritchard said the new policy would not affect any existing HBO contracts. In situations where two companies are now offering HBO services to the same customers, they will be allowed to continue to do so, he said.

But companies signing on for "wireline exclusivity" would be guaranteed that future overbuilders would not be able to gain contracts with HBO.

Mr. Pritchard said the exclusivity provisions do not present any legal problems because "exclusivity is a regular and standard practice in the entertainment industry." He noted that broadcast networks grant exclusivity to their affiliated stations and that movie studios sell theaters exclusive rights to run films.

Mr. Pritchard said the new policy was a way of rewarding those cable operators who have been strongly marketing HBO services. The policy, he said, "makes good business sense to us."

Reaction among multiple systems operators to the HBO plan was generally positive last week, with many top executives saying that they wanted to study the plan further. The HBO policy "is certainly attractive," said one chief executive at a multiple systems operator. "There would be markets where I would like exclusivity."

Reaction from overbuilders was less enthusiastic. Harry Cushing, president of Teleset, which is overbuilding several Florida cable systems, said the HBO policy demonstrates "the length the incumbent MSOs and NCTA (National Cable Television Association) members will go to block development of competitive cable."

Mr. Cushing pointed out that the vertical integration of the cable industry—with Time Inc. owning both HBO and American Television & Communications Corp.—is an obstacle to competitive cable.

Irving Kahn, whose Choice Cable Co. has proposed to overbuild the NYT Cable systems in New Jersey, would say only that "at this point in time we're assuming HBO and the other programming sources will treat us fairly and within the law." □

# Rainbow Offers Ops Exclusivity Contracts

By Debbie Narrod

WOODBURY, NY—Rainbow Program Enterprises last week unveiled its version of exclusivity contracts for pay TV operators carrying Rainbow's sports channels.

The "Marketing Incentive Program," as Rainbow is calling its plan, gives qualifying operators exclusive rights to the sports service in their area as well as the right to license the service to other like operators within a specified territory, if that operator reaches houses the MIP-qualified operator cannot. The MIP, said Rainbow president and chief executive officer Marc Lustgarten, is available to all pay-TV technologies: cable, multichannel multipoint distribution services, satellite master antenna television systems and direct broadcast satellite.

"The principle is that the sports channels are trying to become more widely distributed," Mr. Lustgarten said.

He acknowledged that a cable operator, though, would be interested in the program largely because of the possibility of overbuilds.

To qualify for the MIP, an operator has to be widely available in an area, have wide penetration of the sports channel in that area, and agree to several terms relating to viewership, promotional money to be spent and the area's rate card. Mr. Lustgarten said that the program was structured region by region, and some operators may pay more than they currently do for the channel but others will stay the same.

Rainbow has five regional sports services: SportsChannel New York, SportsChannel New England, SportsChannel Florida, SportsVision Chicago and PRISM of Philadelphia. Some of the channels are pay and some basic, also contributing to the differences in MIP qualifications.

Rainbow also owns Bravo and American Movie Classics. Mr. Lustgarten would not say whether similar programs would be implemented for them, noting it was "easier to get at this [the sports channels] because it is geographic."☐

# Cool response to exclusivity offers

*MSOs have demanded 'overbuild insurance' but now look askance at plans by HBO, others*

**By John Wolfe**

WASHINGTON—Home Box Office's unique "overbuild insurance," which lets cable affiliates purchase exclusive wireline distribution rights for HBO's pay networks, likely will be the first of several such proposals from programmers responding to cable operators' calls for exclusivity. At least three other programmers—Showtime/The Movie Channel, Rainbow Programming Enterprises and The Nashville Network—actively are considering exclusivity offers, network officials confirm.

Meanwhile, operator response to HBO's offer has been decidedly lukewarm. While HBO has received "a number" of signed agreements from operators, most major MSOs "want to have more in-depth conversations with us," according to one HBO official. As a result, HBO's Feb. 15 deadline for the offer is "flexible," the official indicated.

HBO's offer, announced in a letter to affiliates from HBO President Joe Collins, requires affiliates to pay a surcharge of 25 cents per subscriber per month for the exclusive rights to distribute via cable HBO, Cinemax or Festival. The three-year agreement runs from March 1, 1988, to March 1, 1991.

The proposal clearly is aimed at wireline overbuilds, and does not apply to competitive distribution via satellite or microwave, according to HBO. "In the wake of cable deregulation there is a growing concern about overbuilds, particularly as franchises become more broadly interpreted," Collins wrote.

"Not only have overbuilds demonstrated little or no long-term financial viability," he wrote, "but we at HBO also question whether overbuilds are an effective environment for the long-term growth of our programming services." The exclusivity offer, Collins said, will give affiliates "an incentive to continue to aggressively market and promote our brands."

Exclusivity will not be offered in already overbuilt areas or where a franchise is shared by more than one operator, HBO said. The agreement also sets forth a number of conditions which operators must meet. For example, affiliates must participate in HBO's promotional campaigns, must pass 95 percent of the homes within their franchise area and must maintain penetration levels of 12 percent for HBO, 6 percent for Cinemax and 1 percent for Festival.

Affiliates also "may not hold exclusive cable distribution rights for any other pay or basic programming service whose programming consists primarily of theatrical films," HBO said.

Operators recently have placed cable exclusivity high atop their lists of priorities, and programmers in addition to HBO are beginning to respond. Showtime may announce its version of an exclusivity proposal late this month, a network spokesman said.

"We are still very much in the midst of discussions with our affiliates," said the spokesman, who would not reveal details of the proposal. "We're certainly not going to shoot from the hip on this one," he said. "This is very much a decision based on affiliate input."

Rainbow already has announced an exclusivity program for its regional sports services (*CV* 2/15/88 p.11). Rainbow's plan also would enable affiliates to sublicense the networks to TVRO, SMATV and other distributors.

The Nashville Network is considering a proposal in which affiliates, by paying a one cent/subscriber/month surcharge, would obtain exclusive cable distribution rights. TNN's plan is in response to a request from Comcast, which has led the industry's call for exclusivity, a TNN spokesperson confirmed.

But despite the industry's increasingly vocal call for exclusivity, most major MSOs have not rushed to embrace the HBO offer—with one exception. American Television and Communications, HBO's sister subsidiary of Time Inc., said it is "all for" HBO's offer.

"There is no doubt in our mind that exclusivity is important in a competitive environment," stressed Fred Dressler, ATC vice president of programming. "To the extent that (HBO's plan) provides exclusivity," Dressler said, "we're going to take it."

Other MSOs were less committal. Comcast Chairman Bob Clasen termed HBO's offer "a nice gesture to try to be responsive" to affiliates' concerns. "We think it is an interesting effort on their part," he said.

"The concept in its general form has some appeal," said a Tele-Communications Inc. spokesman. But "it's obvious that some additional negotiation on the particulars may be necessary before any agreement can be reached," he said.

A Continental executive was more direct. "We suggested that they need to rethink the whole thing," the official said. "The terms weren't right, nor was the price." The official added that if HBO "wants me to pay a lot for this protection," it would have to be for a much longer period of time.

But "the whole concept of exclusivity is important to the operators, and all the programmers are going to have to focus on this," he continued. "And HBO's got to refocus on this. They don't have the right answer yet."

American Cablesystems, involved in several overbuilds in Florida, likely will not take HBO up on the offer. "I don't think there is much there that is going to be attractive for us," one company official said. "It's going to end up in the courts," he predicted, "and that's not something we want to be involved with."

* HBO's proposal has attracted keen interest from another source: Sen. John Kerry, D-Mass. Kerry, who sits on the Senate communications subcommittee, said that HBO's plan has been "described by some consumer advocates as 'monopoly maintenance.'"

In a Feb. 11 letter to HBO Chairman Michael Fuchs, Kerry said he was "troubled by the appearance that HBO may be involved in efforts to promote one method or kind of retail distribution over another, efforts which can frustrate competition and ultimately harm consumers."

Kerry asked Fuchs how the plan would benefit home viewers and whether the plan came from HBO, Time Inc. or ATC. And "if the wireline exclusivity proposal is not really a strategy directed or developed by HBO's parent company or cable affiliate," he asked, "why is it not in HBO's interest...to promote competition among different retail distributors of its programming?"

An HBO spokesman said the company has not responded to Kerry's letter. ■

FORUM

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# Making the case against overbuilds

## *Most have been financial or operating failures and usually lead to buyouts*

**By Richard Berman**

It shouldn't come as news to anyone that a franchising authority is generally empowered to decide how many cable franchises will be awarded within its particular franchise area. The vast majority of existing cable franchises are, by their terms, "non-exclusive." The House Report accompanying the franchising provisions of the Cable Communications Policy Act of 1984 states that the act grants the franchising authority "the discretion to determine the number of cable operators to be authorized to provide service in a particular geographic area." Such "discretion" is part and parcel of the cable business; territorial non-exclusivity is, in part, a check and balance on the operator's performance.

It is similarly not surprising that throughout the history of the cable industry, significant, lasting overbuilds have been few and far between. Overbuilds have been financial or operating failures, usually giving rise to a buyout by one operator of the other. Despite some recent sound and fury, and despite the record high system sales prices, this is unlikely to change. Current studies, such as those by Touche Ross and Malarkey—Taylor, confirm what many cable operators already believe, namely that overbuilds give rise to increased operating costs and, over the long run, cause upward pressure on rates. The weight of experience and authority is that overbuilds may not only be harmful to the incumbent and the overbuilder, but they are likely also to work a hardship on the customer by increasing subscriber rates. Thus, contrary to an often stated justification for overbuilds, the customer ultimately loses.

If simple economics were not enough to dampen overbuild enthusiasm, the most elemental reading of the political tea leaves should be. This is a crucial time for the cable industry. Cable operators' post-cable act behavior is being closely watched by regulators, by legislators, and by long-time cable industry antagonists. Cable's increasing consumer acceptance and economic well being are the envy of its adversaries. In short, this is the time for building the case *against* overbuilds, not for it. Here it is:

*Richard Berman is a communications attorney and partner in the New York office of LeBoeuf, Lamb, Leiby & MacRae. He was general counsel, executive vice president and a director of Warner Cable Communications from 1978 through 1986, as well as serving as general counsel and secretary of MTV Networks from 1983 through 1986.*

- Most overbuilds serve no valid public purpose. They lead to economic inefficiencies in the form of increased operator costs and increased subscriber rates.
- The cable act says cities have discretion with respect to issuing multiple franchises but it does not say they are required to issue more than one franchise. While the case law is still evolving in the courts, appropriate consideration should be given to such factors as an overbuild's impact on rates, the ability of existing poles and conduits to accommodate additional cable, and so forth.
- Municipal overbuilds waste taxpayers' money and move government into a realm where it doesn't belong—namely editorial control. Utility overbuilds may entail cross-subsidization and predatory pricing.
- Poor operator service can generally be avoided by relying upon meaningful criteria such as past operating experience and financial capability in awarding franchises; it can be remedied by governmental jawboning, franchise non-compliance proceedings, and, if ultimately warranted, non-renewal.
- The cable marketplace is already competitive. Consumers may turn elsewhere—or off—if the cable operator fails properly to do his job.
- The Constitution (equal protection clause) mandates that an overbuilder have the same burdens as the incumbent.
- Incumbents have the right to petition their local franchising authority and argue against a second franchise. They have the right also to resort to the courts when they are legally aggrieved.

In sum, for the cable operator who does his homework and provides good service, the case against being overbuilt is compelling. ■

Readers with strong views on topics of general interest are invited to submit manuscripts for publication. Manuscripts should be no longer than nine or 10 typed, double spaced pages. Send manuscripts to *CableVision*, attention: Linda J. Johnson, 600 Grant St., Suite 600, Denver, CO 80203.

Broadcasting Magazine, March 14, 1988

# Senator raises concerns about HBO exclusivity

**Kerry sends letter to pay programer asking questions about plans for deals with noncable distributors**

Senator John Kerry (D-Mass.), apparently still concerned about distribution deals between cable operators and programers that may discourage competition and inflate subscription fees, has sent Home Box Office a second round of questions on the pay programer's policies toward "noncable distributors" like SMATV and wireless cable operators and on the impact of vertical integration of cable operators and programers on competition.

Kerry's new questions were sent to HBC Chairman and Chief Executive Officer Michael Fuchs, who, a Kerry aide said, may receive a phone call from the senator. The aide also said last week that other programers will be getting similar letters. They include Viacom's Showtime/The Movie Channel and Rainbow Programing Enterprises owned by cable MSO Cablevision Systems.

The letter to HBO went out after Kerry received a four-page letter from Fuchs with responses to the lawmaker's Feb. 11 question about HBO's offer to make cable operators the exclusive "wireline" distributors of HBO's services (HBO, Cinemax and Festival) within their franchises ("Closed Circuit," Feb. 15).

In the March 4 letter, Kerry said he remains "deeply concerned about whether there are impediments to competition in the developing market for satellite-delivered television programing." Refering to Fuch's first letter, Kerry said, "I wish that I could share your confidence that exclusivity will not generate higher consumer prices."

Kerry's second batch of questions: 1) "Whether HBO and other important programing is currently available to noncable distributors and will be available in new contracts; 2) whether programing is sold to noncable distributors and cable overbuilders on discriminatory prices and conditions, and 3) whether competition is threatened by the increasing horizontal and vertical concentration that permits a few MSO's to increasingly control satellite-delivered programing."

Kerry's Feb. 11 letter was prompted by press reports that HBO's "wireline exclusivity" was intended to protect existing cable operators from competition from other cable operators or so-called "overbuilders." Among other things, Kerry wanted details about the offer, its purpose and its effect on competition and consumer prices for cable programing.

In his response, Fuchs said the offer was not intended to provide "overbuild protection" as the reports suggested. It "was devised as a means of protecting our program services in an overbuild environment," he said. "Our concern is that in head-to-head competition, cable operators promote those services that are unique to their own system. We want to assure ourselves that our program services would continue to receive the local marketing and promotional efforts that have historically contributed to our success."

The implication that the offer is intended primarily to benefit operators is "untrue and, judging from the mixed response of our distributors to date, not so perceived by the industry itself," Fuchs said.

"In fact, a continued lack of affirmative response from our best distributors," Fuchs said, "could well result in our withdrawing the proposal entirely."

Kerry's second letter was apparently prompted by Fuch's terse response to a question about HBO's distribution policy toward noncable distributors of cable programing, not directly affected by the wireline exclusivity offer. "Availability of our programing to noncable distributors varies with the particular technology and will remain unchanged as a result of the exclusivity proposal," Fuchs said. □

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# Wireless cable group asks TCI for assurances of programs at fair prices

**Challenge comes in comments to FCC on MSO's proposed $46-million buy of Tulsa, Okla-based Tempo**

Wireless Cable Association, the budding trade association representing operators of so-called wireless cable systems, has challenged Tele-Communications Inc. to provide assurances that it will make the programing of Tempo Enterprises Inc. and other cable programers in which it has interests available to wireless cable operators at nondiscriminatory prices.

The challenge was issued in WCA's comments to the FCC on nation's largest MSO's proposed $46-million purchase of Tempo Enterprises, a Tulsa-based owner of Tempo Television and satellite distributor of Turner Broadcasting System's superstation WTBS(TV) Atlanta. Because Tempo's assets include licenses for three satellite earth stations, the deal is subject to FCC approval.

WCA stopped short of asking the FCC to deny the transfer. But, it said, the FCC "should consider whether there is a way to assure that such vertical integration will not lead to a denial of access to programing for retail competitors of TCI such as wireless cable," it said. "Specifically, TCI should provide assurances that it will sell all its wholly or partly acquired programing to wireless cable firms at nondiscriminatory prices."

James Theroux, president of Metropolitan Cablevision, a wireless cable operator serving Cleveland, and chairman of WCA's regulatory affairs committee, said WCA believes filing a petition to deny would have been a "misuse" of the FCC's license-transfer process. However, he said, the process provides a good forum. "We are looking for public places where we can make our point."

WCA's point is that the market power of cable operators and the vertical integration of operators and programers are making it difficult for wireless cable operators to obtain rights to cable programing and compete with cable operators.

"Individual cable franchisees are local monopolies," WCA said. "In some instances, cable franchisees demand exclusive contracts by which programers agree not to make their product available to competitors of cable. In other instances, the cable operators are indulged by programers who refuse to deal with wireless cable firms. In still other instances, programers will sell to wireless cable firms only if the firms promise not to distribute the programing in competition with cable. Finally, even when programers do offer their wares to wireless cable, they typically charge discriminatorily high prices, for no apparent reason other than, probably, a desire to please cable."

"The ultimate weapon for cable operators to preclude retail competition is the acquisition of preferred programing for the purpose of exclusively distributing it through cable," WCA said. "This weapon has been used with increasing frequency. There are approximately 80 different satellite ... services.... and more than half of such services are owned in whole or in part by cable." TCI, it said, owns a piece of Turner Broadcasting System (WTBS, CNN and CNN Headline News), Cable Value Network, American Movie Classics, Black Entertainment Television, Event TV, Discovery Channel and Fashion Channel.

"If TCI acquires control of... Tempo..., it might refuse to make WTBS and Tempo programing available to wireless cable at a fair price in those areas where wireless cable is in direct competition with a cable operator (which might or might not be owned by TCI)," WCA said. □

Multichannel News — March 14, 1988

# HBO Seen Scrapping Wireline Exclusivity

By Larry Jaffee

NEW YORK — Home Box Office Inc. will withdraw its "wireline exclusivity" offer for overbuild environments, due to a lack of interest from operators, sources said last week.

An HBO spokesperson said the company had no comment on rumors circulating in the industry that such a decision had been made.

However, Michael Fuchs, HBO chairman and chief executive officer, noted in a March 3 letter to Sen. John Kerry (D-MA) that "a continued lack of affirmative response from our best distributors could well result in our withdrawing the proposal entirely."

HBO
Continued from page one

Since the proposal was introduced in January, many operators said they had problems with the contract's terms, which included that all of an operator's systems would be covered by the contract whether or not overbuild situations exist locally (see *Multichannel News*, Feb. 15, page 8).

HBO's withdrawal of the offer will probably mean that Showtime/The Movie Channel Inc. will shelve its exclusivity plan, offered last month, which would be system-specific rather than operatorwide, according to a Showtime spokesperson.

"The timing is bad; there couldn't be a worse time to do this," the spokesperson said. "The company is concerned in light of everything — the reaction (to HBO's offer) and the environment," he continued, referring to a Senate antitrust subcommittee hearing this week in Washington that will look at effective cable competition. He noted that cable oversight hearings in the House are scheduled for March 30.

(HBO president Joseph Collins is scheduled to testify at the Senate hearing.)

HBO originally had extended a Feb. 15 deadline to give operators more time to consider the offer. An HBO spokesperson said late last week that the company "received a few commitments," but would not reveal from which operators.

Several weeks ago the Community Antenna Television Association, representing small operators, said it would oppose the HBO policy because a clause in the contract did not fully protect some operators against several operators who already have agreements allowing them to carry HBO in any system they

# HBO

*Continued from page one*

build.

Continental Cablevision Inc. chairman Amos Hostetter said he doesn't like the HBO offer because it's "too expensive and the time is too short."

"I don't think it was a very well thought-out plan," Mr. Hostetter said, adding that his company was concerned that if the contract was challenged, "we would want a refund." HBO was not prepared to make such a commitment.

Robert Thomson, Tele-Communications Inc. vice president of governmental affairs, said TCI's position was unchanged on the HBO offer. "While there are some intriguing aspects, a lot of negotiations back and forth must take place before any proposal would be seriously considered," he said.

Ernest Olson, vice president of marketing of Metrovision Inc., said the Atlanta-based operator found the additional 25-cent per subscriber per month not worth the expense since the company might not be faced with overbuilders.

HBO's Mr. Fuchs responded in writing to questions that Sen. Kerry had posed regarding the exclusivity proposal, which the senator said he thought might raise antitrust questions (see *Multichannel News*, Feb. 22, page 1).

Sen. Kerry also asked Tony Cox, Showtime/TMC president, and Marc Lustgarten, president of Rainbow Program Enterprises, about their exclusivity proposals.

In his letter, Mr. Fuchs pointed out that press characterization of the proposal as "overbuild protection is both inaccurate and misinformed," adding that the offer was made to promote brand awareness and maintain its identity in the marketplace. He noted that the proposal has received a "mixed response from our distributors."

"Our offer of exclusivity was not designed or intended to protect cable operators from competition; it was devised as a means of protecting our program services in an overbuild environment," Mr. Fuchs said. "Our concern is that in head-to-head competition cable operators promote those services that are unique to their own system.

"We wanted to assure ourselves that our program services would continue to receive the local marketing and promotional efforts that have historically contributed to our success as a provider of premium entertainment to the home viewer," he said.

Although HBO has no control over operators' retail pricing, Mr. Fuchs said HBO did not expect "the modest surcharge associated with exclusivity will not result in higher subscription fees to the home viewer."

The HBO chief also said availability of HBO programming to non-cable distributors "varies with the particular technology and will remain unchanged as a result of our exclusivity proposal." □

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EXHIBIT M

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W. ALLEN MOORE, MINORITY CHIEF OF STAFF

United States Senate
COMMITTEE ON COMMERCE, SCIENCE,
AND TRANSPORTATION
WASHINGTON, DC 20510

February 11, 1988

Mr. Michael Fuchs, Chairman
Home Box Office, Inc.
1100 Avenue of the Americas
New York, New York 10036

Dear Mr. Fuchs:

I am writing to you with a number of questions I have about Home Box Office, Inc.'s offer of "wireline exclusivity" to cable systems and multiple system operators (MSO's) which carry HBO's programming. As a member of the Communications Subcommittee of the Senate Commerce Committee, I have been particularly interested in competition in the developing market for satellite-delivered television programming.

HBO'S wireline exclusivity proposal has been dubbed "overbuild protection" in the trade press and described by some consumer advocates as "monopoly maintenance" based on concerns over its potential impact on home viewers. The wireline exclusivity proposal is also opposed by smaller or independent cable systems which are providing -- or plan -- competitive service in communities currently served by only one cable television system. Non-cable distributors may see this proposal as just another effort, this time directed at part of the cable industry, to deny access to programming that is necessary to compete with the established cable system in franchise areas. I understand that HBO has undertaken other exclusivity arrangements, as evidenced by reports, for example, that HBO is offering to make cable operators exclusive KU-band satellite distributors within their service areas.

HBO is, of course, not the only programmer engaged in activities which raise such fundamental antitrust and communication policy issues, and I am well aware that HBO is affiliated with one of the major cable MSO's, American Television & Communications Corporation (ATC), through its mutual parent Time, Inc. While your corporate parent may not wish to have competitors use HBO to compete in ATC's own

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franchise areas, your policy as announced, does not seem to be limited to just such franchise areas. I am troubled by the appearance that HBO may be involved in efforts to promote one method or kind of retail distribution over another, efforts which can frustrate competition and ultimately harm consumers. Accordingly, I would appreciate your response to the following questions:

1. What benefits do home viewers derive from arrangements such as HBO's wireline exclusivity proposal, and what will it cost them?

2. Would the 25 cents per subscriber fee, apparently to be charged by HBO for exclusivity be collected "up front" when a cable operator agrees to purchase one of HBO's services, or would this fee only be collected in the event an overbuilder competes or threatens to compete with the existing cable operator within a franchise area?

3. Is HBO's wireline exclusivity proposal a policy developed by or directed by HBO's parent company or cable affiliate to advance its own interest?

4. If the wireline exclusivity proposal is not really a strategy developed or directed by HBO's parent company or cable affiliate, why is it not in HBO's interest, and also why is it not in the home viewer's interest, for HBO to promote competition among different retail distributors of its programming, including cable distributors, such as wireless cable, SMATV, and DBS?

5. To what extent do exclusivity arrangements, such as HBO's wireline exclusivity proposal, effectively limit the number of households that HBO can reach, increase prices, and impede competition among those distributors seeking to sell satellite-delivered programming within any local market?

6. To what extent is HBO's programming available now at fair terms and conditions, and will be available in the future, to cable overbuilders and any non-cable distributors who seek to compete with cable distributors for whom HBO is or will be available?

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I am particularly interested in your response in light of recent reports by the National League of Cities and the National Cable Television Association of significant price increases in the price of basic service in a deregulated cable market. As you know, Consumer Reports has quantified consumer dissatisfaction with existing cable services. These issues are similar to those raised late last year when the Committee considered S. 889, the Satellite TV Fair Marketing Act. During the Senate Commerce Committee's consideration of that measure, I raised the question of whether there is fair and adequate competition among alternative distributors and technological means of delivering such programming to home viewers. I will be grateful for your assistance in examining this subject as I prepare for further Senate action on S. 889 and related legislation this Spring.

I look forward to hearing from you.

Sincerely,

John Kerry
United States Senate

cc: Hon. Ernest F. Hollings
Hon. Daniel K. Inouye

James P. Mooney, President,
National Cable TV Association (NCTA)

HBO

Michael J. Fuchs
Chairman
Chief Executive Officer

March 3, 1988

Honorable John Kerry
United States Senate
Washington D.C. 20510

Dear Senator Kerry:

I am writing in response to your letter of February 11 concerning HBO's offer of exclusivity to our cable distributors. Although my schedule has prevented me from responding sooner, I welcome the opportunity to clear up any misconceptions or confusion which may have been engendered by press reports concerning this matter. HBO has been a leader in developing distribution technologies for pay television transmission and uses many different methods to deliver its services to subscribers and distributors. Starting in the 70's HBO used microwave transmission, both multi-point distribution service (MDS) and point-to-point microwave, to deliver its programming. In 1975 HBO was the first regular user of satellite transmission to distribute its service. This step led directly to the emergence of the many television services that exist today. Recently HBO was the first to scramble its service, and by adopting an inexpensive technology available to all programmers HBO has helped make service to TVROs practicable. Not all of these technologies have been successful for HBO, however. For instance, there have been collection and theft problems with the MDS business, and the number of MDS subscribers to HBO is half what it was a few years ago. Nevertheless, HBO continues to be committed to using innovative technologies to deliver its services.

Before providing specific responses to the numbered questions in your letter, I would like to clarify several preliminary matters. The press' reference to our exclusivity proposal as "overbuild protection" is both inaccurate and misinformed. Our offer of exclusivity was not designed or intended to protect cable operators from competition; it was devised as a means of protecting our program services in an overbuild environment. Our concern is that in head-to-head competition cable operators promote those services that are unique to their own system. We wanted to assure ourselves that our program services would continue to receive the local mar-

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keting and promotional efforts that have historically contributed to our success as a provider of premium entertainment to the home viewer. We believe that exclusivity, coupled with the marketing and promotion obligations which a cable operator undertakes in accepting our proposal, best serves our business needs.

I would also like to take issue with the characterization of HBO as "programming that is necessary to compete." Unfortunately, that is an overstatement. The fact is that much of our programming -- theatrical motion pictures -- has already been available to the home viewer on cassettes or pay-per-view for many months prior to its exhibition on HBO and is contemporaneously available on other pay television services. And, although we take pride in the quality and appeal of our original programming, concerts and made for television movies are available to the home viewer on an ever-increasing number of cable services and, of course, on broadcast stations as well. If HBO were as compelling a product as you have suggested, we would not be spending the millions of dollars a year that we devote to marketing, advertising and promotion, and we would not feel it necessary to provide the incentives typified by our exclusivity proposal in order to ensure that our distributors support our efforts on a local level.

The following numbered paragraphs respond to the questions posed in your letter:

1. Program exclusivity is fundamental to the motion picture and television industries and is premised on the belief that in this highly competitive environment a quality of uniqueness is necessary to attract consumer patronage. To the extent that we are successful in continuing to acquire and retain subscribers to our services, it will enable us to improve the quality and quantity of the programming available to the home viewer. Although we have no control over the retail pricing of our distributors, it is our expectation that the modest surcharge associated with exclusivity will not result in higher subscription fees to the home viewer.

2. A cable operator's decision to "purchase" one of our services is independent of an election to accept our exclusivity proposal. If a cable operator does accept our offer of exclusivity, the fee would apply from the outset of our agreement irrespective of any overbuild activity.

3. HBO developed its exclusivity proposal on its own to advance its own business interests. Of course, we discussed our proposal with some of our cable distributors before finally determining to proceed. However, the implicit assumption in your question -- that our proposal is at the behest of and primarily for the benefit of the cable industry -- is both

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untrue and, judging from the mixed response of our distributors to date, not so perceived by the industry itself. In fact, a continued lack of affirmative response from our best distributors could well result in our withdrawing the proposal entirely.

4. HBO is currently available to the home viewer via each of the technologies identified in the question. Moreover, our exclusivity proposal applies only to cable delivery -- it will not affect competition from other delivery means. Insofar as competition between cable distributors will center on the services unique to each of them, we believe that our proposal furthers that competition for the reasons stated above.

5. HBO's exclusivity proposal will have no impact on distributors of satellite-delivered programming other than cable overbuilders, nor will it limit the number of households that HBO can reach. In order to assert exclusivity, a participating cable operator must demonstrate that it has (or will within three years) extended its cable plant to 95% of the homes in its franchise area. We believe that the net effect will be to expand rather than limit the reach of HBO to cable households. Again, we do not anticipate that our proposal will negatively impact retail prices for our services.

6. Our programming is currently available for distribution at standard terms and conditions to any cable operator. In the future, it will not be available to a cable overbuilder in any area in which the incumbent operator accepted our exclusivity proposal and is in compliance with the performance standards contained therein. Availability of our programming to non-cable distributors varies with the particular technology and will remain unchanged as a result of our exclusivity proposal.

As I stated at the outset, our programming services are hardly essential. The competition for viewership includes, at least, all forms of cable and broadcast television, videocassettes and movie theaters. If we believed that making our services available to every prospective distributor regardless of technology and area of service would maximize our revenues, then we would surely do so. Many companies in industries ranging from cosmetics to consumer appliances to automobiles have concluded that making their products available on a selective basis meets their business objectives in a manner superior to being treated as a nameless commodity available to and from all competitors. We firmly believe that our interests are best served by promoting brand awareness and maintaining our identity in the marketplace.

If you have any further questions regarding our distribution policies and practices, please call me. I would be glad to respond as promptly as possible.

Sincerely,

Michael Fuchs

Michael J. Fuchs

[illegible] HOLLINGS, SOUTH CAROLINA, CHAIRMAN

[illegible]

United States Senate
COMMITTEE ON COMMERCE, SCIENCE,
AND TRANSPORTATION
WASHINGTON, DC 20510

March 4, 1988

Mr. Michael Fuchs
Chairman
Home Box Office, Inc.
1100 Avenue of the Americas
New York, New York 10036

Dear Mr. Fuchs:

Thank you for your detailed and thoughtful reply to my letter concerning the potential impact on competition and consumers of HBO's wireline exclusivity proposal. Be assured that I am writing to other programmers who have proposed exclusivity arrangements and I would hope their response to be at least as forthright as your very helpful letter.

I continue to be deeply concerned about whether there are impediments to competition in the developing market for satellite-delivered television programming. I wish that I could share your confidence that exclusivity will not generate higher consumer prices. And I note, your response to my last question strongly suggests that HBO has different policies for non-cable distributors regarding pricing and availability of your programming. Notwithstanding your letter, there are a number of issues I would like to explore further, and would hope my colleague, Senator Metzenbaum, will address in his upcoming Antitrust hearings on this subject.

These include, for example, (1) whether HBO and other important programming is currently generally available to non-cable distributors and will be available in new contracts; (2) whether programming is sold to non-cable distributors and cable overbuilders on discriminatory prices and conditions; and (3) whether competition is threatened by the increasing horizontal and vertical concentration which permits a few MSOs to increasingly control satellite-delivered programming.

Again, I am very grateful for your reply which I will take the liberty of forwarding to Chairman Metzenbaum.

Sincerely,

John F. Kerry

John Kerry

JFK:jbd

United States Senate
COMMITTEE ON COMMERCE, SCIENCE,
AND TRANSPORTATION
WASHINGTON, DC 20510

March 3, 1988

Marc Lustgarten
President
Rainbow Program Enterprises
150 Crossways Park Drive
Woodbury, New York 11797

Dear Mr. Lustgarten:

I am writing to you with a number of questions I have about Rainbow Program Enterprise's offer of "exclusivity" to cable systems and other satellite delivered television retailers which carry Rainbow's sports programming. As a member of the Communications Subcommittee of the Senate Commerce Committee, I have been particularly interested in competition in the developing market for satellite-delivered television programming.

Trade press reports about Rainbow's exclusivity proposal and other recent exclusivity arrangements raise concerns over their anticompetitive effect and detrimental potential impact on home viewers. The exclusivity proposals are also opposed by some cable operators, including small and independent cable systems which are providing -- or plan to provide -- competitive service in communities currently served by only one cable television system. Non-cable distributors may see this proposal, even though Rainbow's proposal is ostensibly "available" to non-cable technologies, as just another effort, because of requirements that they cannot hope to satisfy, to deny access to programming that is necessary to compete with the established cable system in franchise areas.

Rainbow is, of course, not the only programmer engaged in activities which raise such fundamental antitrust and communication policy issues, and I am well aware that Rainbow is controlled by a major cable operator, Cablevision Systems Corporation. While your controlling shareholder may not wish to have competitors use Rainbow to compete in Cablevision's own franchise areas, your policy as announced does not seem to be limited to just such franchise areas. I am also troubled by the appearance that Rainbow may be involved in efforts to promote one method or kind of retail distribution over another, efforts which can frustrate competition and ultimately harm consumers. Accordingly, I would appreciate your response to the following questions:

1. What benefits do home viewers derive from arrangements such as Rainbow's exclusivity proposal, and what will it cost them?

2. Is Rainbow's exclusivity proposal a policy developed by or directed by Rainbow's controlling shareholder to advance its own interest?

3. If the exclusivity proposal is not really a strategy developed or directed by Rainbow's parent company, why is it not in Rainbow's interest, and also why is it not in the home viewer's interest, for Rainbow to promote competition among different retail distributors of its programming, including cable overbuilders and non-cable distributors, such as wireless cable, SMATV, and DBS?

4. To what extent do exclusivity arrangements, such as Rainbow's Rainbow's exclusivity proposal, effectively limit the number of households that Rainbow can reach, increase prices, and impede competition among those distributors seeking to sell satellite-delivered programming within any local market?

5. What are the eligibility requirements and are they such that such that Rainbow's exclusivity offer will be, in practice, available to all pay TV technologies: namely, cable; multichannel, multipoint distribution services; satellite master antenna television systems; and direct broadcast satellite?

6. To what extent is Rainbow's programming, including American movie classics and bravo, available now and in the future, to cable overbuilders and any non-cable distributors who seek to compete with cable distributors for whom this programming is or will be available?

I am particularly interested in your response in light of recent reports by the National League of Cities and the National Cable Television Association of significant price increases in the price of basic service in a deregulated cable market. As you know, Consumer Reports has quantified consumer dissatisfaction with existing cable services. These issues are similar to those raised late last year when the Committee considered S. 889, the Satellite TV Fair Marketing Act. During the Senate Commerce, Committee's consideration of that measure, I raised the question of whether there is fair and adequate competition among alternative distributors and technological means of delivering such programming to home viewers. I will be grateful for your assistance in examining this subject as I prepare for further Senate action on S. 889 and related legislation this Spring.

Sincerely,

John Kerry
United States Senate

JFK/meg

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United States Senate
COMMITTEE ON COMMERCE, SCIENCE,
AND TRANSPORTATION
WASHINGTON, DC 20510

March 3, 1988

Tony Cox, President
Showtime/The Movie Channel
1633 Broadway, 37th Floor
New York, New York 10019

Dear Mr. Cox

I am writing to you with a number of questions I have about Showtime/The Movie Channel offer of "wireline exclusivity" to cable systems and multiple system operators (MSO's) which carry Showtime/TMC's programming. As a member of the Communications Subcommittee of the Senate Commerce Committee, I have been particularly interested in competition in the developing market for satellite-delivered television programming.

Reports in the trade press about Showtime/TMC's wireline exclusivity proposal and other recent exclusivity arrangements raise concerns over their anticompetitive effects and detrimental potential impact on home viewers. The wireline exclusivity proposal is also opposed by small and independent cable systems, which are providing -- or plan to provide -- competitive service in communities currently served by only one cable television system. Non-cable distributors may see this proposal as just another effort, this time directed at part of the cable industry, to deny access to programming that is necessary to compete with the established cable system in franchise areas. I understand that Showtime/TMC has undertaken other exclusivity arrangements, as evidenced by reports, for example, that Showtime/TMC is offering to make cable operators exclusive Ku-band satellite distributors within their service areas.

Showtime/TMC is, of course, not the only programmer engaged in activities which raise such fundamental antitrust and communication policy issues, and I am well aware that Showtime/TMC is owned by one of the major cable MSO's, Viacom International. While your corporate parent may not wish to have competitors use Showtime/TMC to compete in Viacom's own franchise areas, your policy as announced does not seem to be limited to just such franchise areas. I am also troubled by the appearance that Showtime/TMC may be involved in efforts to promote one method or kind of retail distribution over another, efforts which can frustrate competition and ultimately harm consumers. Accordingly, I would appreciate your response to the following questions:

1. What benefits do home viewers derive from arrangements such as Showtime/TMC's wireline exclusivity proposal, and what will it cost them?

2. Is Showtime/TMC's wireline exclusivity proposal a policy developed by or directed by Showtime/TMC's parent company to advance its own interest?

3. If the wireline exclusivity proposal is not really a strategy developed or directed by Showtime/TMC's parent company, why is it not in Showtime/TMC's interest, and also why is it not in the home viewer's interest, for Showtime/TMC to promote competition among different retail distributors of its programming, including cable overbuilders and non-cable such as wireless cable, SMATV, and DBS?

4. To what extent do exclusivity arrangements, such as Showtime/TMC's wireline exclusivity proposal, effectively limit the number of households that Showtime/TMC can reach, increase prices, and impede competition among those distributors seeking to sell satellite-delivered programming within any local market?

5. To what extent is Showtime/TMC's programming available now at fair terms and conditions, now and in the future, to cable overbuilders and any non-cable distributors who seek to compete with cable distributors for whom Showtime/TMC is or will be available?

I am particularly interested in your response in light of recent reports by the National League of Cities and the National Cable Television Association of significant price increases in the price of basic service in a deregulated cable market. As you know, Consumer Reports has quantified consumer dissatisfaction with existing cable services. These issues are similar to those raised late last year when the Committee considered S. 889, the Satellite TV Fair Marketing Act. During the Senate Commerce Committee's consideration of that measure, I raised the question of whether there is fair and adequate competition among alternative distributors and technological means of delivering such programming to home viewers. I will be grateful for your assistance in examining this subject as I prepare for further Senate action on S. 889 and related legislation this Spring.

Sincerely,

John F. Kerry

John Kerry
United States Senate

JFK/meg

EXHIBIT N

# OPENING THE BROADBAND GATEWAY
# THE NEED FOR TELEPHONE COMPANY ENTRY INTO THE VIDEO SERVICES MARKETPLACE
## REBUTTAL TO REPLY COMMENTS OF TELE-COMMUNICATIONS, INC.

Shooshan & Jackson Inc.
1990 M Street, N.W., Suite 450
Washington, D.C. 20036
(202) 887-0550

January 20, 1988

In our paper "Opening the Broadband Gateway,"[1] we showed that the cable industry is earning large monopoly/monopsony profits. These profits represent a transfer of wealth from cable subscribers to owners of cable systems. They also represent misallocation of economic resources.

We argued that the Federal Communications Commission (FCC) should facilitate competition in the cable industry. Encouraging competition is good public policy in any event. Pursuing this policy is urgent with regard to the cable industry in order to alleviate the negative effects of cable's market power.[2]

The Commission can facilitate competition by assuring that satellite-delivered cable network programming is made fully available to cable's competitors at non-discriminatory rates. It can also take important steps to reduce government-imposed barriers to entry in the cable business. Finally, a case can be made for removing or relaxing the cross-ownership restrictions that prohibit entry by telephone companies.

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[1] Shooshan & Jackson Inc., "Opening the Broadband Gateway: The Need for Telephone Company Entry Into the Video Services Marketplace," Washington, D.C., October 1987. See Appendix to Comments of the United States Telephone Association before the Federal Communications Commission in Connection with Telephone Company/Cable Television Cross-Ownership Rules, Sections 63.54-63.58, CC Docket 87-266, November 1987.

[2] Shooshan & Jackson Inc., "Opening the Broadband Gateway," pp. 18-20.

## REPLIES

Our study was filed with the Commission on November 2, 1987 as an appendix to Comments of the United States Telephone Association (USTA). On December 16, 1987, cable interests responded to our arguments. Interestingly, the National Cable Television Association (NCTA) did not challenge our demonstration of cable's monopoly/monopsony profits. The procedures and peripheral assumptions relating to our analysis were vigorously attacked by Tele-Communications, Inc. (TCI).[3] However, TCI fails to argue that cable's monopoly/monopsony power is not excessive; nor does it adduce any evidence on this point.

This paper rebuts TCI's arguments. We show that TCI's reply does not diminish the accuracy or the force of the conclusions in our original filing. Indeed, the numbers that TCI proposes as alternatives to our numbers simply provide further evidence of cable's excessive monopoly/monopsony profits.

Furthermore, we show that, in a number of instances, TCI's Reply Comments deliberately distort the truth. To err is human; but to err so frequently tends to diminish an advocate's credibility.[4]

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[3] See Reply Comments of Tele-Communications, Inc. before the Federal Communications Commission in the Matter of Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54-63.58, CC Docket No. 87-266, December 16, 1987. Our analysis was also attacked by Continental Cable et. al. We rebut some of those comments in this paper. See Reply Comments of Continental Cablevision, Inc., Harron Communications Corporation, Prime Cable Limited Partnership, the Illinois Cable Television Association, and Cooke CableVision before the Federal Communications Commission in the Matter of Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54-63.58, CC Docket No. 87-266, December 16, 1987.

[4] For some reason, TCI continues to mischaracterize a statement we made in a study we performed for the Motion Picture Association of America in July 1986 ("Economic Analysis of Concentrated Ownership of Cable Systems"). In that study, we stated in the opening paragraph that the Federal Communications Commission (FCC) and Congress had concluded that competition from over-the-air broadcasting and other sources justified deregulation of the rates charged by cable systems in most geographic areas. However, we expressly stated that "(w)e do not address that issue here." Rather, our paper focused on the cable industry's monopsony power in the programming input market.

In its reply comments in the matter of "Rules and Regulations Relating to Multiple Ownership of Cable Television Systems" filed on August 5, 1986, TCI quoted portions of (continued...)

## TCI'S ARGUMENTS

TCI's arguments fall into three general categories.

1. It generally criticizes the use of the q ratio.
2. It asserts that the q ratio is not applicable to service providers, such as cable companies.
3. It challenges various aspects of our (Shooshan & Jackson's) numerical estimates of the q ratio.

Let us consider each of these arguments in turn.

### General Criticism of the q Ratio

TCI argues as follows:

> Q ratio theory suggests that in purely competitive markets with complete flexibility and knowledge this fraction should equal 1 . . . this kind of highly theoretical model cannot serve as the foundation for reversing Commission regulation much less recommending Congressional action.[5]

If we understand this argument correctly, TCI is criticizing the use of the q ratio precisely because it has a theoretical foundation. We need only note that many useful insights for practical economic policy come out of this same "highly theoretical" model of pure competition. These insights include the advantages of competition in promoting

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[4](...continued)
that opening paragraph out of context -- omitting our disclaimer about not addressing the issue of competition in the output market.

It was largely in anticipation of this fast and loose scholarship on the part of TCI that we quoted this same paragraph, including the disclaimer, which we even emphasized, in footnote 3 of our USTA study "Opening the Broadband Gateway."

We were amazed that TCI in its reply comments in this proceeding used the same quote out of context and omitted the same sentence. What is even more intolerable is that TCI cites the very footnote in our USTA study in which the disclaimer is emphasized, rather than the original work, as its source. (See TCI Reply Comments, n. 8, at 10.)

Perhaps TCI believes that the only difference between being "ingenious" and being "disingenuous" is a few letters here and there.

[5] TCI Reply Comments, p. 11.

economic efficiency and the benefits of marginal-cost (or Ramsey) pricing. Needless to say, these insights have value, even though the real economy does not satisfy all the assumptions of pure competition.

Similarly, the q ratio provides useful insights for practical economic policy. In particular, it provides a methodology for using data from financial markets in order to detect monopoly profits. The q ratio is especially helpful because noted economists have severely attacked the use of accounting data to detect monopoly profits.[6] Recent articles have also questioned the use of the concentration ratio as an index of acquisition of monopoly rents.[7]

Prominent, refereed economics journals have published a number of articles that discuss the q ratio as an indicator of monopoly profits. All the articles that we could find regard the q ratio as useful for this purpose. Consider the following:

> This article uses Tobin's q, the ratio of the market value of a firm to the replacement value of its physical assets, to measure monopoly power and to examine the relationship between market structure and profitability. Tobin's q is a better measure of monopoly profits than indices of single-period profitability because it measures long-run monopoly power. In addition, it is subject to less measurement error and it contains an adjustment for risk. The relationship between q and long-run monopoly power is established. Provided that all inputs are supplied competitively, q should be highly sensitive to even small amounts of monopoly power.[8]
>
> Professor Michael A. Salinger
> Columbia University

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[6] See, for example, F. Fisher, and J. McGowan, "On the Misuse of Accounting Rates of Return to Infer Monopoly Profits," American Economic Review, 73, March 1983, pp. 82-97.

[7] See Steven Lustgarten and Stavros Thomadakis, "Mobility Barriers and Tobin's q," Journal of Business, vol. 60, no. 4, The University of Chicago, 1987, p. 535. See also Mark Hirschey, "Market Structure and Market Value," Journal of Business, vol. 58, no. 1, The University of Chicago, 1985, p. 89.

[8] Michael A. Salinger, "Tobin's q, Unionization, and the Concentration-Profits Relationship," Rand Journal of Economics, Vol. 15, No. 2, Summer 1984, p. 159 (abstract).

> The primary purpose of this paper has been to test the hypotheses found in the industrial organization literature regarding the structure-performance relationship. A secondary purpose has been to empirically demonstrate the usefulness of, and extend, the introduction given by Lindenberg and Ross of Tobin's q in the industrial organizational area.
>
> To consider the second purpose first, we have argued that Tobin's q can provide a more appropriate measure of firm rents than more standard measures such as accounting profit rates. q bounds total rents that accrue from either market efficiency or monopoly. By relying on market valuation, we avoid many of the shortcomings of accounting rates of return. Further, the use of q is suggestive of the general value of capital market data to investigate issues in industrial organization.[9]
>
> Professor Michael Smirlock
> The Wharton School, University of
> Pennsylvania
>
> Professor Thomas Gilligan
> California Institute of Technology
>
> Professor William Marshall
> Washington University

Dr. Henry McFarland of the U.S. Department of Justice, Antitrust Division, Economic Analysis Group, concluded his study of the railroad industry as follows:

> The data presented in this study indicate that railroads do not earn supracompetitive profits. In fact, values of q for the railroad are substantially below the average value for other nonfinancial firms. The results suggest that the competition that railroads face is sufficient to protect shippers and that stricter regulation is unnecessary.[10]

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[9] M. Smirlock, T. Gilligan and W. Marshall, "Tobin's q and the Structure-Performance Relationship," American Economic Review, 74 (December), p. 1058.

[10] Henry McFarland, "Did Railroad Deregulation Lead to Monopoly Pricing? An Application of q," Journal of Business, vol. 60, no. 3, The University of Chicago, 1987, p. 396.

This paragraph clearly indicates that Dr. McFarland regards the q ratio as useful for detecting monopoly profits.[11] Thus, it appears that TCI's evaluation of the q ratio is at variance with that of the economists who have published in this area.

TCI argues further:

> In spite of its purported objectivity, the valuation and replacement cost elements of the Q ratio reflect numerous subjective judgments yielding substantially different Q ratios.[12]

As a general proposition, it is true that estimates of q reflect subjective judgments and can vary, depending on those judgments. However, the monopoly/monopsony profits of the cable industry are so large that they can be detected by any reasonable procedure for calculating the q ratio. Indeed, we show below that the numbers that TCI itself proposes indicate an excessively high q ratio.

TCI also argues:

> More importantly, the numerical Q ratio itself may be interpreted in as many different ways as there are "experts" calculating it.[13]

There are certainly alternative ways to interpret the q ratio. We acknowledge that it should be interpreted carefully and not mechanically. However, that is no reason for discarding the entire concept. Indeed, if concepts had to be discarded because they could be interpreted differently by different persons, no concept in the law or social science could survive.

However, TCI deliberately distorts our interpretation of the q ratio. TCI states "Shooshan & Jackson argue that a Q ratio greater than one necessarily demonstrates concentration and monopoly or monopsony power."[14] In reality, we considered five different interpretations of cable's high q ratio:

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[11] Notably, Dr. McFarland's analysis is analogous to our analysis of the cable industry. However, the numbers turn out very differently in the two industries. We find that the competition that cable companies face is not sufficient to protect consumers.

[12] TCI Reply Comments, p. 11.

[13] Id.

1. Excessive market power (pp. 8, 16)
2. Workable competition with some market power (p. 8)
3. Disequilibrium with competition growing (pp. 8, 15-16)
4. Superior management (p. 16)
5. Macroeconomic fluctuations in the q ratio (pp. 8-9)

We were able to discard interpretations (2) and (5) by comparing cable's q ratio to that of other non-financial corporations in the United States economy. We discarded interpretation (3) by observing that competition to cable companies is not rapidly growing, except for videocassette recorders (VCRs) which compete primarily with pay services and provide relatively little competition to basic cable services. Overbuilds still affect a small fraction of the cable industry, and none of the alternative technologies (pay TV, DBS, or MMDS) have been doing well. We discarded interpretation (4) because the high prices paid for cable systems apply across the board -- not just to exceptionally well-managed companies. We are left with the interpretation that cable has excessive market power.

In its replies, TCI proposes some alternative interpretations. We demonstrate below that these alternative provide no plausible escape from the conclusion that cable has excessive market power.

Marketing. TCI correctly argues that some of the benefits of past marketing expenses are capital assets that are not reflected in the q ratio. As a result, firms that are marketing-intensive tend to have higher q ratios than firms that are not marketing-intensive.

The problem with this argument (from TCI's point of view) is that cable is not a marketing-intensive industry. TCI states that "marketing costs currently associated with building new systems are approximately $40 per subscriber."[15] This amount is so small that it makes only a trivial difference in our analysis of the q ratio. In our numerical analysis below, we add $40 per subscriber to our estimates of cable's replacement costs. It should be noted that we do not add any marketing costs to the replacement costs of other non-financial corporations. Thus, this procedure tends to the bias the comparison, showing too low a q ratio for cable, relative to that of the rest of the non-financial economy.

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[14] Id., p. 12.

[15] TCI Reply Comments, pp. 13-14.

Anticipated Growth. TCI argues, "To the extent that purchasers of the systems considered by Shooshan & Jackson have anticipated growth in the number of subscribers and the services which those subscribers will purchase, market value increased, and the Q ratio is inflated."[16]

On a theoretical level, this argument is simply wrong. In a contestable market, even with growth, the q ratio equals unity in a steady state. (By steady state, we mean an economic state in which there are no incentives for entry or exit; nor are there expected to be any incentives for entry or exit in the future. This is not a static equilibrium if the market is growing.)

Proof: Suppose the opposite; i.e., the q ratio exceeds unity in a contestable steady state. This means that investors value the firm at more than replacement cost. It follows that the firm must be expected to earn more than a competitive return on replacement cost during some periods in the future. Otherwise investors would not value the firm so highly. But under these circumstances, entrants would be able to come into the market during those periods and earn more than a competitive return. Such expected opportunities cannot exist in a steady state. Hence, the q ratio cannot exceed unity in a contestable steady state. End of proof.

It follows that growth cannot explain a q ratio in excess of one. We must look to the other interpretations discussed above to explain a high q ratio.

Notably, growth does increase the q ratio if the firm is earning monopoly profits. Under these circumstances, purchasers of cable systems will bid up the prices of cable systems in the expectation of extracting monopoly profits from a larger subscriber base in the future.[17]

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[16] TCI Reply Comments, p. 14.

Favorable Financing. TCI argues that the high q ratio for cable systems is partially attributable to the availability of favorable financing. In particular, TCI argues that an existing cable system can get financing on more favorable terms than can an overbuilder.[18]

Indeed, favorable financing may partially explain cable's high q ratio. However, unfavorable financing for potential competitors is simply an entry barrier (or reflective of other entry barriers) that supports the cable industry's market power. The fact that potential competitors are ipso facto poor business risks is the very essence of excessive market power.

Applicability of the q Ratio to Service Providers

TCI asserts that applying the q ratio to service providers is inappropriate because of "intangibles;" e.g., long-term subscriber relationships and loyalties. In making its case, TCI deliberately misreports the academic literature on the q ratio. TCI asserts: "The few subsequent [to Tobin's original article on the q ratio] studies which have analyzed the Q ratio in terms of market power have purportedly done so in the context of 'the industrial sector' or for 'manufacturing' companies."[19] Contrary to this misstatement, the pioneering work in this field estimated q ratios for AT&T and several electric utilities and firms in retail trade as well as industrial firms.[30] The McFarland study, cited by TCI in another context,[31] uses the q ratio expressly to analyze market power in a service industry; namely, the railroad industry.

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[17] Continental Cablevision et al. introduce a variant of the growth argument in their Reply Comments (op. cit., p. 9). They cite a recent article ("Mobility Barriers and Tobin's q") by Lustgarten and Thomadakis: "Firm-specific expectations, proxied here by past sales growth, are a significant determinant of q." Continental et al. then go on to misinterpret this result completely. They assert, "In a growth industry, therefore, one would expect the q ratio to exceed unity. And the existence of a q ratio greater than unity in such a situation does not necessarily reflect market power."

The whole point of Lustgarten and Thomadakis is that structural variables can serve as useful proxies for entry and exit barriers, which may change over time. In particular, rapidly-growing firms may earn monopoly/monopsony profits, because competitors cannot enter and/or expand rapidly enough to eliminate those profits. Thus, rapid growth can be associated with entry barriers. Lustgarten and Thomadakis do not argue that a q ratio in excess of unity does not reflect market power. They simply seek to explain the source of that market power and how it changes over time.

[18] TCI Reply Comments, p. 14-15.

[19] TCI Reply Comments, p. 13.

In general, service industries are not the only ones that have "intangibles." Industrial firms also rely on customer relationships and customer loyalty. Furthermore, cable systems do not have the face-to-face contact that many service firms -- and many industrial firms -- have on a day to day basis with their customers. Hence, there is no reason to think that the market values of cable systems include numerous "intangibles" that market values of other firms in the economy do not also include. Notably, in "Opening the Broadband Gateway," we compared the q ratio of the cable industry to that of all non-financial firms -- not just industrial or manufacturing firms.

## Numerical Issues In Calculating the q Ratio

Empirical studies always involve numerous assumptions, any of which can be challenged in adversarial proceedings. Our estimate of the q ratio is no exception, and TCI has fully availed itself of the opportunity to challenge virtually every aspect of our estimation procedure.

In this section, we briefly defend our procedures against TCI's attacks. The critical point, however, is that niceties of estimation do not affect the general result that the q ratio for the cable industry is excessive -- much larger than the q ratio for other non-financial corporations. Indeed, the numbers that TCI proposes in its reply comments support this general conclusion. Let us now consider each of TCI's criticisms in turn.

Marketing Costs. We previously discussed TCI's argument that some past marketing costs are properly included in replacement costs. Inclusion of marketing costs is not entirely appropriate, since we do not include previous marketing costs in the q ratios of other non-financial corporations. Nevertheless, let us accept TCI's view arguendo. We therefore add $40 per subscriber to our estimate of replacement cost. (It makes no material difference.)

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[30] Eric B. Lindenberg and Stephen A. Ross, "Tobin's q Ratio and Industrial Organization," Journal of Business, vol. 54, no. 1, The University of Chicago, 1981.

[31] TCI Reply Comments, n. 15, p. 18.

Prices for Which Cable Systems Sell. We estimated that in December 1986, cable systems sold for an average of $,1732 per subscriber.[22] TCI cites a Kagan estimate that the average price in the first quarter of 1987 was $1,712 per subscriber.[23] In general, Kagan's estimates are based in part on value allocations for sales that included assets other than cable systems. Such allocations may not reflect true market values. For this reason, we constructed a database that excluded transactions involving substantial assets other than cable systems. We believe that market prices in our database are more reliable than market prices based on value allocations.

Nevertheless, let us accept the TCI figure arguendo. According to our analysis, the per-subscriber prices for which cable systems sold at that time was rising about $30 per month. Thus, a price of $1,712 in the first quarter of 1987 is equivalent to a price of $1,650 in December 1986. We use this figure in our calculations below.

Intangible Assets

In "Opening the Broadband Gateway," we considered only tangible assets and not intangible assets in our estimate of replacement costs for the q ratio. TCI challenges this procedure, observing that intangible costs are often substantial.

Nevertheless, our procedure is correct; including intangible assets in replacement cost would be incorrect. Intangible assets consist primarily of goodwill, which is the accounting entry used to balance the books when a cable company (or other asset) is bought for more than book value. Goodwill often consists primarily of capitalized monopoly/monopsony profits of the purchased company. If goodwill is included in replacement costs, the q ratio can equal unity in equilibrium, even though the firm earns substantial monopoly/monopsony profits.[24]

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[22] Shooshan & Jackson Inc. "Opening the Broadband Gateway," p. 10.

[23] P. Kagan, Cable TV Banker/Broker, 10 (October 22, 1987) in TCI Reply Comments, p. 16.

TCI observes that franchise values of cable systems, which are intangible assets, are often substantial. However, the franchise is simply a barrier to entry to potential competitors.[25] Money expended to erect such a barrier is not properly included in replacement cost in the q ratio. Otherwise the q ratio would be less than unity in a purely competitive or contestable equilibrium (where there are no barriers to entry).

value of being first?

Cost to Replace with New Plant

In "Opening the Broadband Gateway," we estimated the replacement cost of cable systems in two steps. We first estimated the cost of replacing embedded cable plant with new assets. We then adjusted our estimates to reflect the fact that embedded plant is not as good as new plant. In this subsection, we consider TCI's criticisms of our estimates of the cost of replacing embedded plant with new plant. The next section considers TCI's criticisms of our adjustments.

TCI correctly observes that there is not a single per-subscriber replacement cost that applies to all cable systems. We took account of several reasons why costs may vary in our sensitivity analysis. In particular, we considered possible cost differences between using aerial, as opposed to buried, construction. We examined cost differences, depending on the type of converter used; e.g., addressable or not. We also considered a range of per-mile construction costs for outside plant. This range reflects, among other things, the effect of varying density of subscribers (per square mile) on costs.[26] Density of subscribers depends on both population density and penetration level.

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[24] The excerpt from Professor Salinger's article, supra., explicitly acknowledges that the q ratio should be based on the replacement cost of physical assets.

[25] Notably, the right to use streets and public rights-of-way does not, in itself, convey commercial value. Commercial value is conveyed only because potential competitors are denied these rights. No commercial value is conveyed if rights are conveyed to everyone; e.g., the right to drive trucks on city streets.

[26] Shooshan & Jackson Inc., "Opening the Broadband Gateway," pp. 12-13, Tables 1-3.

According to our database, the average book value of tangible assets of cable systems is about $499 per subscriber. We also estimated that cable plant is 27.5 percent depreciated. This means that cable plant is, on average, about three years old. TCI does not challenge these estimates.

It follows from the above numbers that the original cost of the assets of the cable systems in our database is about $688 per subscriber. We would expect the cost to replace the embedded assets with new assets to be somewhat higher than $688 per subscriber, because the assets are on average three years' old. We must add about three years' inflation to the original cost, less the cost savings caused by technological change.

Our benchmark estimate of the cost to replace the assets with new plant is $758 per subscriber. This amount consists of $519 per subscriber for plant and $239 for other assets ($499 per subscriber for book value of total assets less $260 per subscriber for book value of plant). Thus, our estimate allows 10 percent appreciation from three years' inflation. This estimate is quite reasonable. Inflation has been moderate in recent years, and the electronic equipment used by cable companies is subject to rapid technological progress.[27]

TCI provides an alternative estimate of replacement costs of $1,000 per subscriber. This estimate seems unreasonably high. It implies an unrealistically high inflation rate of about 10 percent per year. (In our database, assets that are, on average, three years' old had an original cost of $758 per subscriber.) Perhaps, the TCI estimate is not based on the number of subscribers of a mature system; perhaps, the cost estimates were inflated by TCI's engineers; or, perhaps, they have no basis at all.

In any event, let us accept arguendo TCI's estimate of replacement costs. Even with this high estimate, we can show that the q ratio of the cable industry is far higher than for other non-financial corporations in the U.S. economy.

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[27] In "Opening the Broadband Gateway," we cited a study by Malarkey-Taylor Associates (Economic Analysis of Cable System Overbuilds, Washington, D.C., January 1987) to support our cost estimates. We show here that such cost estimates are reasonable, apart from the Malarkey-Taylor study.

Depreciation

In "Opening the Broadband Gateway," our estimates of replacement costs are reduced by the amount of depreciation of the embedded plant. TCI questions this procedure, claiming that it "does not appear to be consistent with the economic literature upon which they rely."[28]

In reality, economic theory requires that replacement cost be reduced by the amount of economic depreciation. If depreciation is not taken into account, the q ratio is less than unity in a purely contestable steady state.

Proof: Assume the opposite. That is, suppose that in calculating the q ratio, we define replacement cost as the cost of replacing embedded plant with new plant (with no adjustment for depreciation). Suppose further that in a purely contestable market, the q ratio, so calculated, is unity. It follows that the embedded firm must be expected to earn a competitive rate of return on new replacement cost. Under these circumstance, an entrant could expect to earn supracompetitive returns by entering the market using new plant. The new firm would have lower long-run costs than the incumbent firm, because new plant has a longer remaining life than does embedded plant. The entrant might also have greater revenues if the new plant has greater channel capacity than the embedded plant. Such opportunities for expected supracompetitive returns cannot exist in a purely contestable steady state.
End of proof.

It follows that the replacement cost used in the q ratio must be adjusted for depreciation. In "Opening the Broadband Gateway," we used book depreciation as a proxy for the theoretically correct economic depreciation. This is a reasonable procedure.

Nevertheless, in our numerical analysis below, we accept arguendo the procedure suggested by TCI. That is, we make no adjustment whatever for depreciation. The q ratio still turns out to be excessive.

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[28] Shooshan & Jackson Inc., "Opening the Broadband Gateway," p. 17, n. 14.

## Estimate of q Ratio Using TCI's Numbers

Although TCI attacked our numbers and suggested numbers of their own, TCI failed to complete the analysis by calculating the appropriate q ratios. Let us now calculate the q ratio based on the numbers and procedures proposed by TCI:

| | |
|---|---|
| Price for which cable systems sell: | $1,650 per subscriber |
| Cost to replace with new plant: | $1,000 per subscriber |
| Additional "investment" in marketing: | $ 40 per subscriber |
| Adjustment for depreciation: | $ 0 |
| Resulting q ratio: | $1,650/($1,000 + $40 - $0) = 1.59 |

This q ratio can be compared to the q ratio of 0.805 for all non-financial corporations.[29] Thus, the q ratio for the cable industry, even using TCI's proposed numbers and procedures, is almost twice that of the rest of the non-financial economy. Given our rejection of alternative explanations for the high q ratio, we conclude that the cable industry is earning excessive monopoly/monopsony profits. Indeed, even with TCI's numbers, expected monopoly/monopsony profits are about 60 percent of the book value of the industry's tangible assets.

Furthermore, while TCI's own numbers prove our point, we must emphasize that we believe 1.59 is a gross underestimate of the q ratio for the cable industry. For the reasons discussed above, our original benchmark estimate of 2.81 is a more accurate and defensible figure.

## Rate Increases Since Deregulation

In "Opening the Broadband Gateway," we cited the large cable rate increases that have occurred this year as further evidence of monopoly/monopsony profits. We cited a Kagan study that found that rates increased 23.8 percent and a study by the National League of Cities that found rate increases of 27.5 percent.[30]

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[29] Lawrence H. Summers, "Stock Prices, Inflation and q," Harvard University (Massachusetts), updated October 1987.

[30] Shooshan & Jackson Inc., "Opening the Broadband Gateway," pp. 16-17.

TCI observes that the Kagan number applies only to cable systems that changed rates during 1987.[31] According to National League of Cities, over 82.6 percent of cable systems in their study raised rates during the first six to seven months of 1987. Hence, the average rate increase for all cable systems -- those that changed rates and those that did not -- was 19.7 percent (23.8 percent X 0.826). These rate increases occurred during a period in which the aggregate inflation rate was only 2.7 percent. This strongly confirms our general point that cable rate increases have been excessive and indicate excessive market power.

TCI further cites a study conducted by the National Cable Television Association.[32] According to that study, cable rates increased by 10.6 percent in the first six months of 1987.

Unfortunately, the methodology used by NCTA has debilitating weaknesses. The response rate was only 23 percent. Managers of cable companies that are proud of their records in keeping down rate increases were probably more likely to respond than those that just had embarrassingly large rate increases. Hence, the NCTA estimates probably contain a substantial negative bias. Furthermore, apparently no attempt was made to verify that cable companies accurately reported rate increases. For these reasons, the NCTA study provides no reliable evidence on cable rate increases.[33]

## Conclusions

In "Opening the Broadband Gateway," we adduced evidence that cable has excessive market power. TCI strongly attacked our analysis.

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[31] TCI Reply Comments, p. 19.

[32] NCTA, "Rate Deregulation: Cable Industry Pricing Changes and Service Expansion in a Deregulated Environment," in TCI Reply Comments, p. 19.

[33] For more detailed discussion of the NCTA study, see Shooshan & Jackson Inc., "Review of NCTA Study, Rate Deregulation: Cable Industry Pricing Changes and Service Expansion in a Deregulated Environment," prepared for the United States Telephone Company (December 16, 1987).

In this paper, we have refuted TCI's criticisms as well as the criticisms made by other cable commenters. We showed that the TCI filing contains a number of deliberate distortions and mischaracterizations of evidence. We also showed that even using TCI's numbers and recommended procedures, one obtains evidence of excessive market power in the cable industry.

# # #

# Does Cable Television Really Face Effective Competition?

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# Does Cable Television Really Face Effective Competition?

Janusz A. Ordover[1]

## Introduction

Is cable television a local monopoly or does it face effective intramodal and intermedia competition? An answer to this question must be given before sound public policy toward cable television can be devised. In 1985, the FCC concluded that cable television faces effective competition from broadcast television in those local communities where there are at least three off the air television signals available to television viewing households in any portion of a cable community. The Commission found that the availability of three broadcast television signals is enough to ensure an effective competitive constraint on the ability of a local cable system operator (CSO) to charge "noncompetitive" rates and to offer a less than desirable programming mix to subscribers.[2] This "three signals" conclusion was used to implement the rate deregulation provisions of the 1984 Cable Act,[3] that is, where effective competition in the form of three broadcast signals exists, cable firms may charge as much as they wish for basic service.

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[1] Janusz A. Ordover is a Professor of Economics at New York University. Yale M. Braunstein, Professor, University of California at Berkeley contributed to the preparation of this analysis.

[2] Implementation of the Provisions of the Cable Communications Policy Act of 1984, 50 Fed. Reg. 18637 (1985).

[3] The Cable Communications Policy Act of 1984, Publ. L. 98-549, 98 Stat. 2779 (1984).

We have been asked to review critically the Commission's findings regarding the extent of effective competition between cable and broadcast television. Our analysis has two main purposes. First, to ascertain whether the methodology used by the FCC to reach its findings is consistent with widely accepted precepts of economic analysis, based on current conditions, and reflective of a sufficiently broad range of considerations. Second, to review the scant data from the deregulated cable markets in order to gauge the likelihood that cable faces competition where three broadcast signals are available.

We do not aim here to provide a rigorous statistical test of intermedia competition or to provide a detailed forecast of the likely effects of deregulation on the cable industry. Such an exhaustive undertaking would be impossible in the limited amount of time available to prepare this report. Nevertheless, we have reached certain conclusions. These are summarized as follows:

> First, the analytic methodology used by the FCC to gauge the extent of effective competition between cable and broadcast television did not conform to widely-accepted economic methodologies.
>
> Second, the cable industry has been undergoing rapid structural and other changes which potentially cast doubt on the validity of the "three signals" finding (which was based on data from 1984 and earlier).
>
> Third, presumably because of its perception of broadcast TV as the main constraint on cable television, the FCC has understated the social value of alternative video technologies, such as wireless cable or MMDS, SMATV, and DBS.
>
> Fourth, the available, albeit scant data indicates that the only unambiguous gainers from cable

rate deregulation have been holders of local franchises.

Fifth, future analysis of competition issues requires substantially more fact-finding and sounder methodologies than employed by the FCC.

## 1. FCC's Analysis of Effective Competition Suffers From Fundamental Methodological Problems

A scrutiny of the analytic approach adopted by the Commission in support of its "three signal" rule reveals significant methodological flaws. These flaws cast grave doubt both on the validity of the conclusions and on the desirability of the rule itself. We shall argue that the methodology adopted by the Commission in deriving criteria for "effective competition" in the cable television market is not based on standard economic indicia or substitutability among various entertainment/information services.[4] In fact, it appears that the Commission first formulated the desired policy conclusion and then sought to develop data that, if it did not prove the conclusion, at least would not undermine the conclusion.

The Commission's major premise apparently is that cable television competes in a broadly defined "home video market" in which cable, over-the-air television, STV, MDS, SMATVs, and DBS, "all offer alternatives that appear to be perceived as substitutes."[5] This approach would be based essentially on the observation that a variety of media deliver "information and entertainment" to the public. Thus, the FCC's approach hypothesizes a broad market in which cable television allegedly competes for the viewers' attention and dollars against VCRs, AM-FM radio, movie theaters, print media, and so on. It appears, furthermore, that in constructing the relevant product market, the FCC failed to give adequate consideration to such important considerations as the multichannel capacity of cable systems and cable's ability to provide packages of programming to subscribers.

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[4] Thus, we concur to some degree with the comments filed by the U.S. Dept. of Justice. See Comments of the U.S. Dept. of Justice, MM Docket No. 84-1296, January 28, 1985.

[5] This is a view advanced by economists Jonathan D. Levy and Peter K. Pitsch in their article "Market Delineation, Measurement of Concentration, F.C.C. Ownership Rules," p. 203, in V. Mosco (ed.), Policy

The Commission's approach begs a fundamental question which goes to the heart of public policy toward cable television. This is: Do alternative technologies for delivering video programming actually provide effective competition to cable? Effective competition cannot be engineered by assumption. Strength of competition has to be assessed using sound economic methods, such as those outlined below, which conform to the criteria suggested by the Department of Justice.

Instead, in its analysis the FCC merely assumed a broad product market in which cable television competes with broadcast television (and other media). It then proceeded to determine how much competition is needed in that product and

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Research in Telecommunications, Ablex Publishing Corp. (1984), pp. 201-212. See also Levy and Pitsch, "Statistical Evidence of Substitutability Among Video delivery Systems," in E. Noam (ed.), Video Media Competition: Regulation, Economics, and Technology, Columbia University Press, (1985), pp. 56-92.

geographic market to offer effective competitive constraints on the market power of cable system operators. The Commission concluded that the theoretical presence of three broadcast television signals of adequate quality reception would sufficiently restrain whatever market power a cable system operator ("CSO") might have.

Apparently the number three was reached on the basis of empirical studies showing that adding a fourth broadcast TV station to a market does not have a statistically perceptible effect on basic cable subscription levels.[6] This approach was pioneered some time ago by John Kwoka.[7] He demonstrated that in certain instances the creation of a strong third-ranked firm out of two lesser-ranked firms could cause prices to fall despite an increase in measured market concentration. Regardless of the econometric and analytic merits or demerits of Kwoka's study,[8] it is certain that his work did not answer what should be the key question: whether the presence of three broadcast television stations in a geographical market ensures that prices and "clusters" of cable services offered by a CSO reasonably well approximate the social ideal. Kwoka showed only that a current level of price may fall following the creation of a strong third or fourth player. Kwoka's findings necessarily apply only to markets (or industries) that deviate from a fully competitive ideal[9] so that the current level of price generates rents to the leading firms. This is because if the market were highly competitive (or fully contestable), the price could not fall any further as a result of increased concentration.

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[6] The Commission's order refers to a study by NCTA/CATA "providing factual support for a standard based on fewer than three signals." ¶ 97. It also cites Arbitron data showing that in two signal markets cable viewership of off-air signals was equal to or greater than off-air viewership of such signals. The opposite was found to be true of three signal and greater markets. ¶ 99. The report assumes that cable itself is the fourth competitor in a three-signal market. Interestingly, none of these findings goes directly to the issue of effective competition between cable and broadcast TV.

[7] See J.E. Kwoka, "The Effect of Market Share Distribution on Industry Performance," The Review of Economics and Statistics, 1, 1979, pp. 101-109.

[8] For a criticism of Kwoka's study, see W.F. Meuller and D.F. Greer, "The Effect of Market Share Distribution on Industry Performance Reexamined," The Review of

The relevance of the Kwoka-type analysis to the public policy issues regarding media market power is very limited. This analysis fails to consider whether three broadcast stations and one cable operator actually make for an adequately competitive market. Instead, it merely suggests that the presence of a fourth broadcast TV station does not necessarily make for a comparatively more competitive market than a market comprising three broadcast TV stations and one cable system.

The FCC's conclusion regarding effective competition is thus troubling. It is also surprising in

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Economics and Statistics, 2, 1984, pp. 353-357.

9/ Kwoka's results also apply to markets which are not perfectly contestable. Baumol, W.J., J.C. Panzar, and R.D. Willig, Contestable Markets and the Theory of Industry Structure, Harcourt Brace Javanovich, 1982.

light of the availability of an appropriate conceptual method of analysis developed by the Antitrust Division of the Department of Justice in the 1982 Merger Guidelines.[10/] In fact, this is the very methodology that the Department urged the FCC to adopt in implementing the Cable Act.

Conceptually, the Guidelines methodology can be readily applied to the problem of determining the degree of effective competition between cable television, on the one hand, and broadcast television (or other media) on the other hand.[11/] In essence, following the Guidelines methodology,

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[10/] DOJ Merger Guidelines methodology for constructing relevant product and geographic markets can be summarized in a sequence of steps. Step 1: determine a product or service whose pricing and quality are to be analyzed. Here, the relevant product or service may be basic cable or cluster of services provided by cable systems. Step 2: Determine the relevant suppliers in a given geographic area. Here, the relevant supplier will be the monopoly cable franchise, in most cases. Step 3: Determine which products or services constrain the ability of firms identified in Step 2 to profitably elevate the relevant prices above some chosen benchmark level by a small but significant amount for a nontransitory period of time. In most situations examined by the Antitrust Division, the hypothesized price increase used has been 10 percent and the nontransitory period of time has been pegged at two years. However, in some limited circumstances, the Division used smaller (5%) and larger (15%) price increases. Step 4: Construct the relevant market comprising firms identified in Steps 2 and 4. See, J.A. Ordover and R.D. Willig, "The 1982 Department of Justice Merger Guidelines: An Economic Assessment," 71 California L. Rev. 535 (1983), for a more detailed analysis of the pertinent methodology. 1982 Merger Guidelines, 47 Fed. Reg. 28,493 (1982) and 1984 Merger Guidelines, 49 Fed. Reg. 26,823 (1984).

[11/] For an example of application of the Merger Guidelines in video markets, see Lawrence J. White, "Antitrust and Video Markets: The Merger of Showtime and the Movie Channel as a Case Study," in E. Noam (ed.), Video Media Competition: Regulation, Economics, and Technology," we would say that the availability of broadcast television contemplated under the Commission's standard offers effective competition to cable television if, following decontrol of basic rates, cable system operators would find it unprofitable to elevate basic rates by 10 percent and maintain them at this higher level (in real terms) for at least two years. It is theoretically possible, of course, that such a rate increase might be unprofitable in markets with three or more broadcast television stations (as the Commission asserts) and profitable in franchise areas in which there are fewer than three broadcast television stations. However, the analytic studies that are available suggest that the Commission's definition of effective competition is probably wrong.[12]

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Columbia University Press, (1985), pp. 338-363.

[12] A study by G. Kent Webb, The Economics of Cable Television, Lexington Books, (1983), found that basic cable penetration increases with the number of off-the-air channels it carries, suggesting that to some extent basic cable services and broadcast television are complements. However, improvements in the quality of broadcast television tend to reduce basic's penetration, other factors remaining the same. Thus, on this score, the two media are substitutes, at least to a limited extent. Webb's study strongly suggests that it is pay cable which competes with broadcast television. Obviously, to the extent that the potential subscriber must pay basic rates before obtaining premium services, the price of basic affects demand for premium services. It is difficult to know what one should make of Webb's results. From our standpoint, however, the key question is the price elasticity of demand for cable services as a "function of" the number and quality of broadcast television stations. Webb's results suggest that no matter what is the actual numerical value of this elasticity, it is likely to be small. A recent study by Browne, Bortz and Coddington, as reported in Cable TV Franchising, Paul Kagan Assoc., July 20, 1986, p.3,

Indeed, the Commission may have misunderstood the most basic phenomenon of the cable industry. Namely, it is possible that broadcast TV viewers have been defecting to cable TV,[13] so that cable may be constraining broadcast TV, as the Commission appears to believe. Yet it does not follow necessarily that broadcast is effectively constraining cable television at current cable rates and program offerings.

How realistic is it that a price increase of a magnitude of ten percent in current subscription rates would prove unprofitable to a cable system operator? Some important insights can be obtained by making an assumption about a representative CSO's mark-up on average subscriber charges, that is, CSO's variable cost to price margin.[14] Straightforward calculations used for illustrative purposes show, for example, that when the cost to price ratio margin is one over three, a 10% rate increase would be unprofitable if it were to induce as much as fifteen percent reduction in penetration. The one over three cost to price ratio means that the variable cost (averaged among all disconnecting subscribers) would be a third of the average subscription

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supports this suggestion.

13/ See, for example, M.O. Wirth and H. Bloch, "The Broadcasters: The Future Role of Local Stations and the Three Networks," p. 121-122, in E. Noam (ed.), Video Media Competition: Regulation, Economics, and Technology, Columbia University Press (1985), pp. 121-137.

14/ Note that an increase in a basic rate may induce some disconnections among those subscribers who also purchased pay tiers. It is for this reason that we must focus on an average mark-up.

rate.[15] Inspection of the mathematical formula indicates that the higher the cost-price ratio, the less likely it is that a 10% price increase would prove unprofitable because of the number of disconnects it induced. [See Appendix A1 for calculations based upon various cost - price ratios and rate increases.]

The available data indicate that the variable cost components for basic services are a small percentage of revenue from basic, perhaps as low as 9%.[16] On the other hand, these costs can be as high as 50% for premium programming services. In light of these facts, our illustrative ratio is not unreasonable. The available evidence also tends to suggest that price increases of this magnitude did not cause a substantial reduction in cable's penetration in those communities that already have cable, although the real magnitude of these price increases must be adjusted in some cases by accounting for changes in the offerings included in various basic (or first) tiers. (*See* section 2a infra.) As shown in Table 1, nationwide cable penetration increased in the first quarter of 1987.

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[15] The mathematics are as follows. The change in profits, denoted by $dL = p\ q[(dp/p) + (dq/q)(1-[\text{variable cost}/p])]$, where p denotes subscription rates and q the number of subscribers. We fix dp/p at 0.1 or 0.15 and fix the price-cost ratio at some appropriate level and then calculate (dq/q) that would cause the change in profits to be negative.

[16] Two caveats are necessary here. First, the variable costs are low because most of the investment is either sunk or fixed. Consequently, long-run variable costs may be higher than those postulated in the text. Second, as discussed in section 1(b)(i), basic is undergoing an unprecedented transformation in the present marketplace.

## 2. FCC's Analysis of Effective Competition is Outdated In View of Significant Programming and Structural Changes in the Cable Industry

The FCC's 1985 conclusion is also potentially flawed because the market it examines is already antedated. A new picture of that market suggests strongly that cable has the ability to obtain monopoly rents. The most important elements of the new picture are "tier meltdown" and structural changes in the degree of horizontal and vertical integration.

### a. Tier Meltdown.

During the last few years, CSOs have tended to include more attractive programming choices in the basic tier. This is in contrast with the early days of classic 12-channel cable systems when the basic service included principally (1) must-carry stations (the locally available broadcast TV signals), and (2) some locally originated programming. In fact, in many early systems only a single basic tier was available to subscribers.

Subsequently, cable operators began using microwaves to import distant television signals for retransmission. With the advent of satellites, additional program offerings, such as HBO, The Movie Channel, Showtime, etc., were made available in cable systems on pay-per-channel basis. Cable systems acquired greater channel capacity which enabled them to increase their offerings. In turn, growing channel capacities stimulated new programming. Ironic, but pertinent for public policy, is the fact that channel space for new offerings is now scarce in some cable systems.

During that period, which lasted until quite recently, the economics of cable television pricing were driven by the presence of demand-interdependencies among various offerings of cable services. In particular, a CSO had to allow for the fact that changing the price of basic service increased the actual price (thereby reducing demand) for premium services. CSOs thus employed sophisticated price discrimination strategies that enabled them to maximize revenue from subscribers of different tastes. In addition, and perhaps of equal importance, because subscription rates for pay tiers were by the mid 1970s almost totally deregulated and were often not included in the base for franchise fees, the CSOs sought to shift as much programming as possible into higher (premium) tiers to maximize their pricing freedom and net revenue.

In the wake of the 1984 Cable Act, cable operators have begun to increase the number and variety of offerings that are included in basic. As a result of this new marketing strategy, the basic tier now offers not only retransmission (i.e., higher quality reception of broadcast TV), and local programming, together with a "right" to purchase higher tiers, but also increasingly varied and better quality programming. The ongoing simplification of the pricing of basic and premium services by cable systems is due to a combination of factors. The most important of these are:

(i) customer resistance to and confusion with complex tiering of services;

(ii) changing offerings as program suppliers enter and exit the supply side of the distribution chain, resulting in periodic realignments of tiers;

(iii) vertical integration of cable and program suppliers;

(iv) increased power of cable system operators in negotiations with franchising authorities. This has resulted from two events: (a) the end of the "franchising wars," and (b) deregulation and preemption by Congress.

Overall, through increased clustering of offerings in basic tiers, the trend has been to reposition these tiers in the product space of information and entertainment services. It is difficult to determine with precision the consequences of that repositioning on effective competition among the providers of video-based entertainment and information. In our opinion, repositioning potentially has eased the constraint, if any, that broadcast television imposes on basic cable. This is because strategies designed to reposition products (here cable offerings) are primarily motivated by the desire to reduce the degree of head-on competition, not to enhance it. In brief, basic cable still subsumes broadcast, but its reshaping has made it a distinguishable product.

As a product, basic cable now is the availability 24 hours a day and seven days a week of all of the following: news (including the specialties of financial, sports, weather, headline, feature, live, local, and general national news), sports (of different sports and multiple games within most major sports), children's variety, adult variety, religious offerings, shopping (ranging from fashionable clothes to bizarre geegaws), and movies. In terms of the continuous availability of this smorgasbord of programming, no three broadcast stations, even taken as a group, can compare; basic cable offers a distinct product.

Thus the product market that was considered by the FCC prior to its deregulatory rulemaking has changed. It is probably less competitive than it was then,[17] but at least the Commission ought to re-examine the marketplace. In doing so, the Commission should use better methodologies, and should determine the implications of product repositioning and tier meltdown on the degree of effective competition among different modes of reaching the television-viewing public.

b. Structural Changes.

Perhaps of even greater consequences for public policy are the structural changes in the cable industry since the passage of the Cable Act of 1984 and the FCC's 1985 deregulation ruling. These structural changes include both increasing concentration in cable ownership and increasing vertical integration between CSOs, program distributors, and production companies. Concurrently with this trend towards increased horizontal concentration and tighter vertical links in the programming-distribution chain, cable system operators have at times implemented programming practices whose impact on competition is potentially suspect.

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[17] In the DOJ Comments, it was concluded at 18 that ". . . broadcast television is generally not a good substitute for the full range of programming and other services distributed by cable television. These reasons include the large variety of video programming usually carried on cable systems (. . . .) and the inability to market 'pay' services successfully over broadcast television." DOJ at 18.

(i) Horizontal Integration.

Some consolidation of the ownership of cable systems took place prior to deregulation. It seems, nevertheless, that deregulation -- combined with favorable merger policy and a rising stock market -- greatly spurred the trend towards consolidation of ownership in the cable industry. Recent estimates indicate that of all cable subscribers (more than 40 million households), 46 percent are directly or indirectly controlled by 5 companies.[18] In 1985, the top 50 companies accounted for 70 percent of the nation's nearly 35 million subscribers. The two major MSOs, Tele-Communications Inc. (TCI), and American Television and Communications Corp. (ATC), now control approximately over 30 percent of all subscribers, with TCI alone controlling 22 percent. The biggest MSO is TCI which owns 600 cable systems with approximately eight million subscribers in 44 states. The second largest MSO, ATC (a subsidiary of Time, Inc.), owns 660 cable companies with 3.5 million subscribers in 32 states. TCI alone has spent nearly $3 billion acquiring over 150 cable systems in the last three years.

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[18] These figures are culled from various issues of Cablevision.

It has been estimated that, in 1986, approximately nine billion dollars was spent on mergers and acquisitions by the largest MSOs. One industry official has commented that it would not be surprising to see as many as five to eight of the top 20 companies disappear through horizontal integration of the next five years.[19/]

This trend towards increasing concentration has not been appreciably slowed by the rising prices of the transactions. In 1986, the average per subscriber value of one company's acquisitions, for example, was $1399 and the cash flow multiple on a projected first year basis was 10.5. For another company, the average value per subscriber was $1254. In some key targeted cable areas, i.e., Florida and California, prices of $2000+ per subscriber are not uncommon. Prices in 1986 generally averaged between $1200 and $1300 per subscriber. However, prices ranged widely from $900-$1200 for the very few remaining classic (i.e., older systems with only small capacities which typically offer only broadcast stations) cable systems to $1500+ for large or underdeveloped systems. And by 1987, the per subscriber prices have gone into the $2000+ range, according to trade press reports. In contrast, in 1984 (prior to cable deregulation), cable systems could typically be acquired for $800-$900 per

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[19/] These estimates were reported in Cablevision, January 19, 1987.

subscriber. As of late 1985, the going price was reported to be $1100-$1200. The strong per subscriber prices were also reflected in the average projected first year cash flow multiple paid for systems in 1986, the average of which ranged from 10.5 to 11.5.

There is very strong reason to suspect that deregulation made it possible for CSOs to better extract profits from their local franchises. To the extent that there is no evidence that, on average, CSOs were unprofitable (on a replacement cost basis) prior to deregulation, deregulation must be strongly considered as an important explanatory variable behind the increases in per-subscriber prices paid by the purchasers.

The available financial data on the sales prices of cable franchises can indirectly be used to obtain some estimates of the degree of monopoly power held by local cable franchises. One analysis looks at the ratio of the value of the productive asset in the financial market to its replacement value. This ratio is high when the asset has market power attached to it. In particular, in highly competitive markets the ratio -- denoted as the q-ratio -- should approximately equal one. Based upon an analysis of 153 recent sales of cable systems, Shooshan and Jackson Inc. have calculated q-ratios for 1986.[20/] Their study estimates

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[20/] Shooshan and Jackson, Inc., "Opening the Broadband Gateway: The Need for Telephone Company Entry into the Video Services Marketplace," (1987), Washington, DC, submitted in FCC CC Docket No. 87-266.

the q-ratio for the cable industry as of December 1986 at 2.81.[21] Obviously, in light of additional increases in the per subscriber acquisition prices in 1987, the value of the q-ratio has increased substantially as well.[22] The study concludes that the explanation for the high q-ratio is that the cable industry has excessive market power. Thus, these analysts conclude that although there are many potential and actual alternatives to cable, these alternatives do not adequately constrain the monopoly power of cable systems.

(ii) Vertical Integration

Another dramatic manifestation of structural changes in the cable industry is the growing degree of vertical integration. "Forward" and "backward" vertical integration has been taking place. Thus, MSOs have been integrating into programming.

Vertical integration by major MSOs into programming services is linked with the concentration of system ownership.[23] This is because large MSOs have assured captive subscribers which reduces the risks of substantial investments in programming.

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[21] This ratio is what Shooshan and Jackson call their middle-of-the-road estimate. They also calculate two other estimates: one with a high adjusted replacement cost and the other with a low adjusted replacement cost. The q-ratios for these estimates are 2.27 and 3.28, respectively. The q-ratio for a competitive market is equal to one. Higher q-ratios occur in concentrated industries where there are barriers to entry and there are few mechanisms to reduce monopoly profits.

[22] As we pointed out, however, the general increase in stock market prices over the 1984-87 period contributed to the increases in the calculated q-ratio.

[23] See, e.g. Lawrence J. White, "Antitrust and Video Markets: The Merger of Showtime and the Movie Channel as a Case Study," in E. Noam (ed.), Video Media

Interestingly, for a programmer the audience base provided by cable is more secure than is the audience when the programming is delivered via broadcast. An advertising-supported delivery technology must be sensitive to the size of the viewing audience for every minute of programming. By contrast, the analysis for a CSO of the value of any programming turns on whether a particular service increases penetration, not how much (or even whether) anyone watches that service. Another way of making this point is to note that the product delivered by cable to consumers is the continuous availability of a range of programming, but the product broadcast TV claims to its advertisers that it delivers to consumers is an audience measured by the number that actually watches a given program. The audience size obviously fluctuates more widely than does the number of subscribers.

At the same time, vertical integration may be welcome to a programmer that has experienced the substantial buying power (monopsony power) of large MSOs, with their unchallenged grip over cable subscribers. Indeed, it is well-known that large MSOs frequently pay dramatically lower per subscriber fees than those paid by smaller systems.

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Competition: Regulation, Economics and Technology, Columbia University Press, (1985), pp. 338-363.

This is not the place to explore in detail the extent of vertical integration in the industry and the ongoing changes. However, as can be seen from Tables 2 and 3, several of the largest MSOs are owned by media corporations who are among the largest cable programmers. Many of the cable system operators and the program packagers also have interests in program production and other aspects of distribution. Furthermore, data indicate that subscribers to the cable systems operated by vertically integrated firms are most likely to subscribe to each firm's jointly-owned pay service.24/

Economists generally presume that vertical integration and vertical business practices are driven by efficiency considerations.25/ However, whether a quest for efficiencies fully explains vertical integration in the cable industry, as well as some other programming practices, has yet to be fully explored. Indeed, economists have recently

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24/ See B.M. Compaine, Who Owns the Media, Second edition, White Plains: Knowledge Ind. Publ. (1982). See also, Shooshan and Jackson, Inc., Economic Analysis of Concentrated Ownership of Cable Systems, Washington, D.C., 1986, and "Cable TV: The Issues," Consumer Reports, September 1987.

25/ See, e.g., M.K. Perry, Vertical Integration: Determinants and Effects, Bell Corporation (Belcore) Research Paper (June 1987) and M.L. Katz, Vertical Marketing and Franchising Agreements, UC Berkely Bus. School (September 1987) both forthcoming in R. Schmalensee and R. Willig, Handbook of Industrial Organization, North-Holland Publishers (1988).

pointed out that, at least in principle, vertical practices can have anticompetitive horizontal consequences.[26]

Thus, for example, through vertical integration MSOs may deny programming to alternative cable technologies, such as MMDS ("wireless cable"), which constitute a head-on threat to cable's control of the local market.[27] Such anticompetitive tactics are easier to carry out when a distributor (a large MSO, for example) also owns an important programming source.[28] In addition, as the MSO becomes larger, the more credible become its threats to disadvantage the program vendor at the distribution level if it refuses to cooperate with the distributor's programming tactics. Such a disadvantage could be produced, for example, by placing the vendor's program on a high channel, where it is less likely to be viewed by subscribers, or by refusing to carry the service. Other tactics could include overpricing a particular program or not including it in the optimal tier.

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[26] See T.G. Krattenmaker and S.C. Salop, "Anti-competitive Exclusion: Rising rivals' costs to achieve power over price," 96 Yale L. J. 209-295, (1982); and J.A. Ordover et al., "Non-price anti-competitive behavior by dominant firms toward the producers of complementary products," in F. Fisher (ed.), Antitrust and Regulation, MIT Press (1985).

[27] See, "Cable Television v. The Alternatives: A Study in Antitrust," prepared by the Office of Congressman Charles E. Schumer (Sept. 14, 1987), for an argument that incumbent MSOs have prevented entry of new cable distribution technologies.

[28] D.T. Scheffman and P.T. Spiller, "Buyers and Entry Barriers," Federal Trade Commission, Bureau of Economics Working Paper No. 154, August 1987.

Another business strategy of CSOs is, in effect, the sale of channel placement to programmers by means of obtaining from program vendors a discount from the price in exchange for preferential placement. Because broadcast television stations cannot sell their programming to cable at any market-related price, they do not have at present an efficient mechanism for competing with other programmers for valuable channel assignments.

To the extent that the FCC may be correct that independents actually compete for viewers and advertising revenue with cable systems,29/ the decisions to move these stations to higher channels should at the very least raise some concern. This is because the need to ensure that the pursuit of legitimate business objectives -- which includes maximization of profits from distribution of programming -- by cable systems should not undermine the public policy objective of securing a wide range of programming choices for cable subscribers and other television audiences. On the other hand, to the extent that broadcast television programming is valuable to cable systems, perhaps it should be placed on equal footing with other programming products in its ability to compete for valuable channel location. This is especially important for the local stations that are no

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29/ National cable advertising revenues, although small in proportion to those of broadcast networks, have been increasing rapidly. Revenues were $546 million, $735 million and $930 million from 1984 through 1986 respectively. Estimates for 1987 advertising revenues are $1.142 billion, a 10 percent increase over 1986.

longer protected by must-carry rules and for whom exclusion or suboptimal channel placement could amount to a financial death sentence.

It is not our view that regulation of the MSOs' programming decisions is necessarily a desirable public policy. It is our opinion, however, that in light of the structural changes in the cable industry, such programming decisions can assume consequences which did not previously exist. To the extent that they do, they raise serious public policy concerns.

### 3. The FCC Has Paid Insufficient Attention to Alternate Delivery Technologies

It seems clear that aside from direct head on competition from another wired cable system -- as it exists in overbuilds --- the most plausible constraint on the market power of local cable franchises should come from alternative delivery technologies such as MMDS or wireless cable, SMATV, and DBS.[30/] The available evidence suggests that these alternative cable technologies have not yet made significant inroads into the "video marketplace." The troublesome possibility, however, as recent developments in the cable industry strongly suggest, is that entry impediments have increased rather than decreased in the post-deregulation marketplace.

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[30/] Direct competition from cable systems owned and operated by fiber-optics-using telephone companies has yet to materialize. Its future is mired in complex legal and regulatory battles.

Interestingly, the FCC has expressed little interest in facilitating entry of these technologies. Indeed, having found that broadcast television offers an effective constraint on cable in many local franchises, the Commission paid mere lip service to alternative technologies which allegedly are inferior from the engineering standpoint to standard cable. The Commission's stance however, confuses economic benefits with engineering assessments. From the social standpoint, the relevant benefits from those alternative technologies have to be related to the associated costs. For example, the fact that some of these technologies can offer fewer channels of programming than state-of-the-art cable systems is not enough to dismiss them from the marketplace. In many respects, these technologies entail fewer sunk costs, are less expensive to install, and are cheaper to maintain than are standard cable systems. In addition, their presence in the marketplace would afford additional competition to incumbent CSOs which could inure to the benefit of cable subscribers.

### 4. The Effect of The 1984 Cable Act on The Cable Industry: Who Has Benefitted?

It is too early to render a definitive judgment on the social benefits engendered by the FCC's implementation of the effective competition provisions of the 1984 Cable Act. However, the available data indicate that so far the only unambiguous beneficiaries of the Act have been the owners of cable systems. The advantages for consumers are unclear, at best.

The owners of cable systems plainly have benefitted through increased prices paid by buyers for the existing cable systems. Cable system owners have also benefited from the ability to raise basic subscription rates without interference from regulatory authorities. Subscribers have suffered as a result of these price increases, at least to the extent that these price increases exceed the benefits from additional programming that the operators are now increasingly including in the basic tier.[31/]

Tables 4 and 4a show the history of average monthly basic cable rate increases since 1979.[32/] During the period 1979-1985, the average rate increase granted to operators requesting rate increases was between 13.6 percent and 17.8 percent (with an average increase of 15.3 percent over the period) above the old rates. In 1986, the average basic cable rate had increased 20 percent above the old rates for those operators that had increased their basic rates. For the first half of 1987, cable operators, no longer subject to rate regulation, have increased their basic cable rates by approximately 24 percent. In a 1986 survey of 282

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[31/] A recently released study by National Cable Television Association (NCTA) shows that from December 1986 to June 1987, basic subscribers in a surveyed sample received an additional 1.6 channels in their basic package, going from 27.3 to 28.9 channels. "Rate Deregulation: Cable Industry Pricing Changes and Service Expansion in a Deregulated Environment," NCTA, Washington, D.C. (November 1987).

[32/] The data are estimates of Paul Kagan Associates as reported in their publications, Cable TV Franchising and the Kagan Census.

cable operators, the Cable Television Administration and Marketing Society found that 75 percent of those surveyed planned rate increases ranging from relatively low increases to more substantial increases (30 percent). On average, the expected increase would be 18.5 percent.[33/]

In a more recent survey conducted by the National League of Cities of 233 franchising authorities covering 274 franchises serving 4.68 million subscribers, it was found that 82.6 percent of the cable operators surveyed increased their basic rates. In 40.4 percent of the rate increases, the number of services included in basic services also increased. In the other 42.3 percent where the number of services was not increased, the average increase of basic rates was 27.5 percent. Of the 42.3 percent that did not increase the number of services, however, 17.3 percent decreased their pay service rates. Of the remaining cable operators surveyed, 14.4 percent did not change their basic service rates while only 2 percent reduced their rates.[34/] Even a recently released study of the deregulated cable industry by National Cable Television Association found that, in a sample of 598 responding cable systems[35/] which reach

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[33/] This is reported by Laura Landro, "Cable TV's New Freedom Promises Higher Prices - but More Services," Wall Street Journal, p. 31, C4, Dec. 12, 1986.

[34/] National League of Cities, Impact of the Cable Act on Franchising Authorities and Consumers, Washington, D.C., September 18, 1987.

[35/] The overall response rate was 23%. There is no evidence one way or the other whether the responding cable systems were significantly different from those which

16% of cable households, the average basic rate increased by 10.6% since January 1987. NCTA's estimates appear to be very low in comparison with those reported by other sources.

Table 4 also compares annual industry average basic cable rates to the average rate increases for those systems granted increases in the same year. (See also Figures 1-3). During the period 1979-86, rate increases for the average system obtaining a rate increase were approximately 3 percent to 5 percent higher than the industry average. In 1985, the average system that obtained a rate increase was almost equal to the industry average. While 1987 figures are not yet available, it seems likely that the rate increases for those operators raising their rates will be higher than the industry average as the number of rate changes has also increased significantly. In 1986, for example, there were rate changes in 566 communities in 40 states. In contrast there have already been 968 rate changes in 45 states in the first half of 1987.[36]

Accompanying the relative price changes, a survey by the National League of Cities also shows that there was a reduction in the number of basic service tiers in 1987. Approximately 17 percent of the MSOs surveyed reduced their basic service tiers; 80.8 percent offered no change; and only 2.3 percent actually increased the number of basic service

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failed to respond to the questionnaire.

[36] Estimates of Paul Kagan Associates, Cable TV Franchising News Roundup, September 31, 1987, p. 2.

tiers. Prior to deregulation, 57.7 percent of the cable operators offered only one basic service tier; 25.7 offered 2 tiers; 11.3 percent offered 3 tiers; and 5.4 percent offered 4 or more tiers. After deregulation, 71.2 percent offered one basic tier; 18.1 percent offered two tiers; 6.2 percent offered 3 tiers and 4 percent offered 4 or more tiers.

Thus, the available evidence strongly points to increased basic rates in the deregulated marketplace. In addition, as Paul Kagan observes, CSOs pushed through substantial rate increases in anticipation of full deregulation in January of 1987. As stated in The Pay TV Newsletter, "[w]ith anticipation of full deregulation in January 1987, cable operators took the lid off basic rates in 1985. According to KAGAN CENSUS data, operators hiked basic rates by a record 11%...."37/ And, as we noted in Table 4, substantial rate increases took place in 1986. Indeed, over the past two and a half years, basic rates increased by about a third, substantially in excess of increases in the CPI.

It is important to note that it is not possible to use the surveyed data on prices to test whether the FCC's "three signal" rule for estimating effective competition is valid. First, neither the National League of Cities nor the NCTA relates price changes in particular franchises to the number of available broadcast television signals, which is the key issue here. Second, the NCTA study neglects the fact

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37/ The Pay TV Newsletter, Paul Kagan Associates, May 30, 1986, p.4.

that basic rates increased rapidly during 1985 and 1986. Third, the studies do not indicate whether the basic rates in the regulated environment were substantially below monopoly levels. Indeed, if these rates were close to monopoly levels, deregulation would not have a significant impact on basic rates. Nevertheless, the fact that rates have been increasing rapidly suggests that some previously unexploited pricing power is now available to CSOs.

### 5. The FCC Can And Should Do Better Analysis Than That Which Resulted in The "Three Signals" Finding

This synopsis suggests that the short history of the deregulation of cable is far from a picture of unambiguously procompetitive behavior. Deregulation was not required to bring financial health to a sickly business, as it did for the railroad industry for example. In fact, prior to deregulation cable companies were in sound financial positions (especially if they were able to renege on promises made during franchise bidding wars). Also, deregulation did not bring lower prices to a mass of cable subscribers, as it did in the airline industry.[38] In fact, subscription prices appear to have risen substantially even after making allowance for expansion of programming included in basic service. And, finally, deregulation did not induce the entry of new competitors as it did in the airline industry. In fact, the alternative cable technologies are finding the deregulated environment largely inhospitable to entry and expansion. Under these circumstances, as implemented by the FCC, the 1984 Cable Act may have been unwise legislation. In any event, the radical changes in the marketplace to which the Act has contributed demonstrate that the Commission's conclusions about competition for cable are, at a minimum, based on out-of-date information and poor methodology.

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[38] See, e.g., S. Morrison & C. Winston, "The Economic Effects of Airline Deregulation," The Brookings Institution (Washington, DC), 1986.

Table 1

U.S. Cable Penetration

(1985-1987)

| | Total Systems | Percent Increase | Basic Subscribers | Percent Increase | Pay Units | Percent Increase | Homes Passed | Percent Increase | Total Franchised Homes | Percent Increase |
|---|---|---|---|---|---|---|---|---|---|---|
| 1985 | 6675 | | 30759556 | | 25599448 | | | | | |
| 1986 | 7546 | 0.13 | 36931375 | 0.20 | 27042372 | 0.06 | 52171078 | | 47023634 | |
| 1987* | 7836 | 0.04 | 38762246 | 0.05 | 28637268 | 0.06 | 55477512 | 0.06 | 49890122 | 0.06 |

* As of April 1, 1987

Source: Television and Cable Factbook, 1985, 1986 and 1987 Editions.

Table 2

Pay Cable Packager--Cable System Operator Ties
(1978-79 Data)

| Corporate Owner | Pay Cable Packager | Number of Affiliates | Subscribers | Cable MSO | Number of Systems | Subscribers |
|---|---|---|---|---|---|---|
| Time, Inc. | Home Box Office | 800 | 2,000,000 | ATC[1] | 94 | 714,000 |
| (Joint Venture) | Showtime | 260 | 650,000 | Teleprompter | 110 | 1,110,000 |
| | | | | Viacom | 30 | 360,000 |
| Warner | Star Channel | 17 | 105,000 | Warner | 140 | 576,000 |
| | | ---- | -------- | | --- | -------- |
| TOTALS | | 1077 | 2,755,000 | | 374 | 2,760,000 |
| % OF NATIONAL TOTALS[2] | | | 84% | | | 19% |

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Source: Braunstein (1980)

Notes:

[1] Does not include Manhattan Cable (94,000 subscribers)

[2] Based on 14,500,000 cable subscribers and 3,300,000 pay subscribers

Table 3

Pay Cable Packager--Cable System Operator Ties
(1984 Data)

| Corporate Owner | Pay Cable Packager | Number of Affiliates | Subscribers | Cable MSO | Number of Systems | Subscribers |
|---|---|---|---|---|---|---|
| Time, Inc. | Home Box Office | 5,000 | 12,500,000 | ATC | 463 | 2,400,000 |
| (Joint Venture)[1] | Showtime/ | 3,100 | 5,000,000 | Viacom | 19 | 752,000 |
| " | The Movie Channel | 2,900 | 3,000,000 | Warner Amex | n/a | 1,383,000 |
| TOTALS | | 11,000 | 20,500,000 | | | 4,535,000 |
| % OF NATIONAL TOTALS[2] | | | 100% | | | 15% |

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Sources: Broadcasting Cablecasting Yearbook and Television & Cable Factbook

Notes:

[1] Owners of combined Showtime/The Movie Channel joint venture:

| | |
|---|---|
| Viacom | 50% |
| Warner Amex | 31% |
| Warner Communications | 19% |

(one of the owners of Warner-Amex).

[2] Based on 30,000,000 cable subscribers and 20,500,000 pay subscribers.

TABLE 4

| Year | (1) Average Old Rate | (2) Average Rate Increase Granted* | (3) Average Percent Increase (By Year) [(2)-(1)]/(1) | (4) Rate of Increase of Basic Rates | (5) Industry Average Basic Rate | (6) Industry Percent Increase (By Year) [(5)-(1)]/(1) | (7) Rate of Increase Industry Rates | (8) Percentage of Difference [(2)-(5)]/(5) |
|---|---|---|---|---|---|---|---|---|
| 1979 | 6.75 | 7.76 | 14.96 | -- | 7.53 | 11.56 | -- | 3.05 |
| 1980 | 7.03 | 8.08 | 14.94 | 4.12 | 7.85 | 11.66 | 4.25 | 2.93 |
| 1981 | 7.32 | 8.36 | 14.21 | 3.47 | 8.14 | 11.20 | 3.69 | 2.70 |
| 1982 | 7.70 | 8.88 | 15.32 | 6.22 | 8.46 | 9.87 | 3.93 | 4.96 |
| 1983 | 7.92 | 9.22 | 16.41 | 3.83 | 8.76 | 10.61 | 3.55 | 5.25 |
| 1984 | 8.31 | 9.79 | 17.81 | 6.18 | 9.20 | 10.71 | 5.02 | 6.41 |
| 1985 | 9.00 | 10.23 | 13.67 | 4.49 | 10.24 | 13.78 | 11.30 | -0.10 |
| 1986 | 9.51 | 11.41 | 19.98 | 11.53 | 11.08 | 16.51 | 8.20 | 2.98 |
| 1987 ** | 10.26 | 12.70 | 23.78 | 11.31 | N/A | N/A | N/A | N/A |

* For 1979 through 1986, rate/system increases granted by local authorities. In 1987, basic rate increases were deregulated.

** First six months of 1987 only.

(1) Rate/system.

(2) Includes tiers.

(5) Rate/subscriber.

Source: Paul Kagan Associates, Cable TV Franchising, various issues.

TABLE 4A

| Year | (1) Average Old Rate | (2) Average Rate Increase Granted* | (3) Average Percent Increase (By Year) [(2)-(1)]/(1) | (4) Rate of Increase of Basic Rates | (5) Industry Average Basic Rate | (6) Industry Percent Increase (By Year) [(5)-(1)]/(1) | (7) Rate of Increase Industry Rates | (8) Percentage of Difference [(2)-(5)]/(5) |
|---|---|---|---|---|---|---|---|---|
| 1986 | 9.51 | 11.41 | 19.98 | 11.53 | 11.08 | 16.51 | 8.20 | 2.98 |
| 1987(i) ** | 10.26 | 12.70 | 23.78 | 11.31 | 12.70 | 23.78 | 14.62 | 0.00 |
| 1987(ii) ** | 10.26 | 12.70 | 23.78 | 11.31 | 12.27 | 19.59 | 10.74 | 3.50 |
| 1987(iii)** | 10.26 | 12.70 | 23.78 | 11.31 | 12.10 | 17.89 | 9.16 | 5.00 |

1987(i) Estimated 1987 industry average equal to average rate increase.
1987(ii) Estimated 1987 industry average 3.5 percent less than the average rate increase.
1987(iii) Estimated 1987 industry average 5.0 percent less than the average rate increase.

* For 1979 through 1986, rate/system increases granted by local authorities.
In 1987, basic rate increases were deregulated.
** First six months of 1987 only.

(1) Rate/system.
(2) Includes tiers.
(5) Rate/subscriber.

Source: Paul Kagan Associates, Cable TV Franchising, various issues.

Notes to accompany Table 4:

The table compares annual average basic cable rates (rate/subscriber) to the average rate increases for cable systems that were granted rate increases (rate/system) in the same year.

Columns 1-4 summarize data for just those cable systems that were granted rate increases. Column 1 shows the average basic rate prior to the rate increases; Column 2 shows the average rate increase that were granted for 1979-1986. Column 3 shows the percentage increase in basic rates in any year for those systems that had rate increases granted. Column 4 calculates the percentage change of the average rate increase granted by local authorities over time.

Column 5 shows the annual average basic cable rate (rate/subscriber) for the period 1979-1986. Column 6 shows the percentage increase of annual average cable rates for each year calculated using the average old rate as the standard of comparison. This calculation will differ slightly from that in Column 3 since it calculates the average basic rate of all cable systems (i.e. including those which did not have rate increases granted and those which had not applied for a rate increase in any particular year). Column 7 shows the increase of the annual average basic rate over time.

Column 8 shows the difference between the average rate increase granted to cable systems (Column 3) and the annual average basic rate (Column 6). It shows that, between 1979 and 1986, the average cable system that was granted a rate increase charged approximately 3 - 5 percent more than the industry average.

Table 4A uses the data in Table 4 to calculate estimates of the annual industry average basic cable rate in 1987. Using the average rate increase of those cable systems that had increased their basic rates in the first six months of 1987 as a benchmark, we calculate three estimates of the average basic rate for 1987. The different estimates depend upon assumptions of how much the annual average basic rate will differ from the average rate increase for those cable systems that increased their rates. Since this difference averaged between 3 and 5 percent throughout the period 1979-1986, the first estimate is made on the assumption that the annual basic rate will be the same as the average rate increase of those systems that raised their rates; the second is that the annual average rate will be less than the average rate increase by 3.5 percent; and the third is that the annual average rate will be less than the average rate increase by 5 percent. These estimates seem reasonable in light of the increasing number of rate increases that have already taken place in 1987. In 1986, for example, there were rate changes in 566 communities in 40 states and the average cable system that was granted a rate increase charged roughly 3 percent more than the industry average basic rate. In contrast, there were 968 rate changes in 45 states in the first half of 1987.[1] Therefore, the larger percentage of all cable systems increasing their rates would tend to make the average rate increase by cable systems that have raised their rates closer to the industry average in 1987.

In a recent survey of cable rate deregulation by the National Cable Television Association (NCTA),[2] the average basic service rate that an average subscriber paid in July 1987 was found to be $13.11. The NCTA study shows that the rate increase for the cable systems surveyed had increased by 10.6 percent between December 1986 and July 1987. Using their estimate of the average basic rate in July 1987, the increase of the industry annual average basic rate over that which prevailed in 1986 would then be 18.3 percent (significantly higher than our relatively conservative estimates). In contrast, in 1985-1986 the industry annual average basic rate had increased by only 8.2 percent.

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[1] Estimates of Paul Kagan Associates, Cable TV Franchising News Roundup, September 31, 1987, p.2.

[2] National Cable Television Association, Rate Deregulation: Cable Industry

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*Pricing Changes and Service Expansion in a Deregulated Environment*, November 1987.

Figure 1: Average Rate Increases Granted
Versus Changes in the
Consumer Price Index (CPI)
By Year (1979-1987)

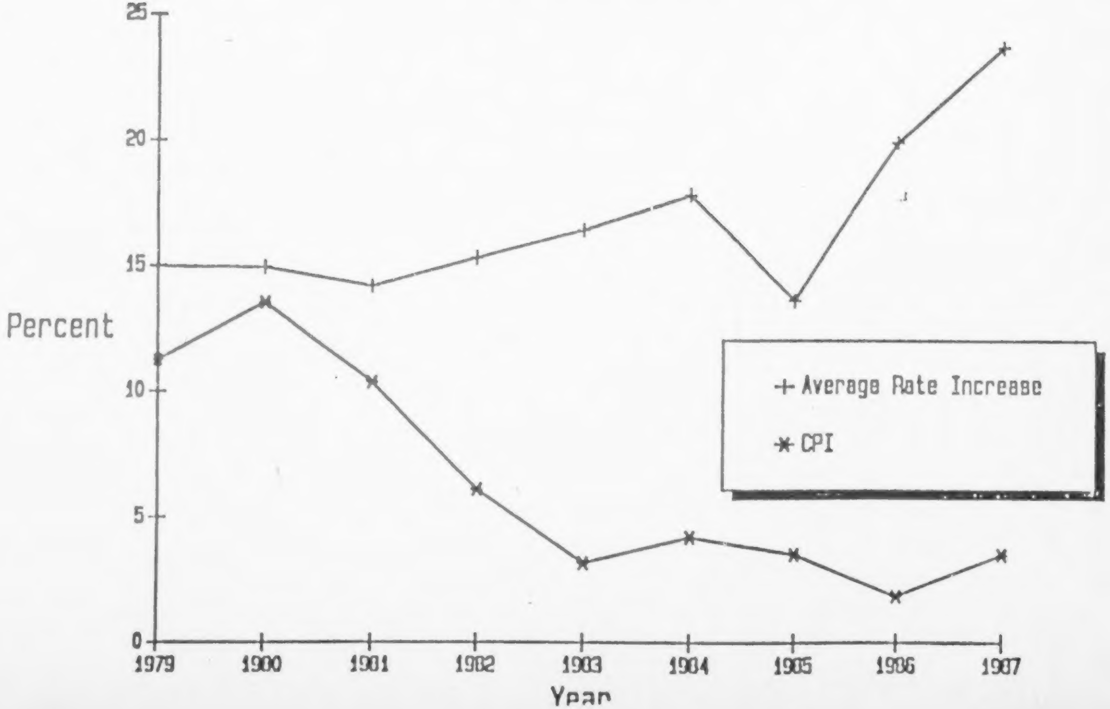


Figure 2: Industry Average Rates/Subscriber
(1979-1987)

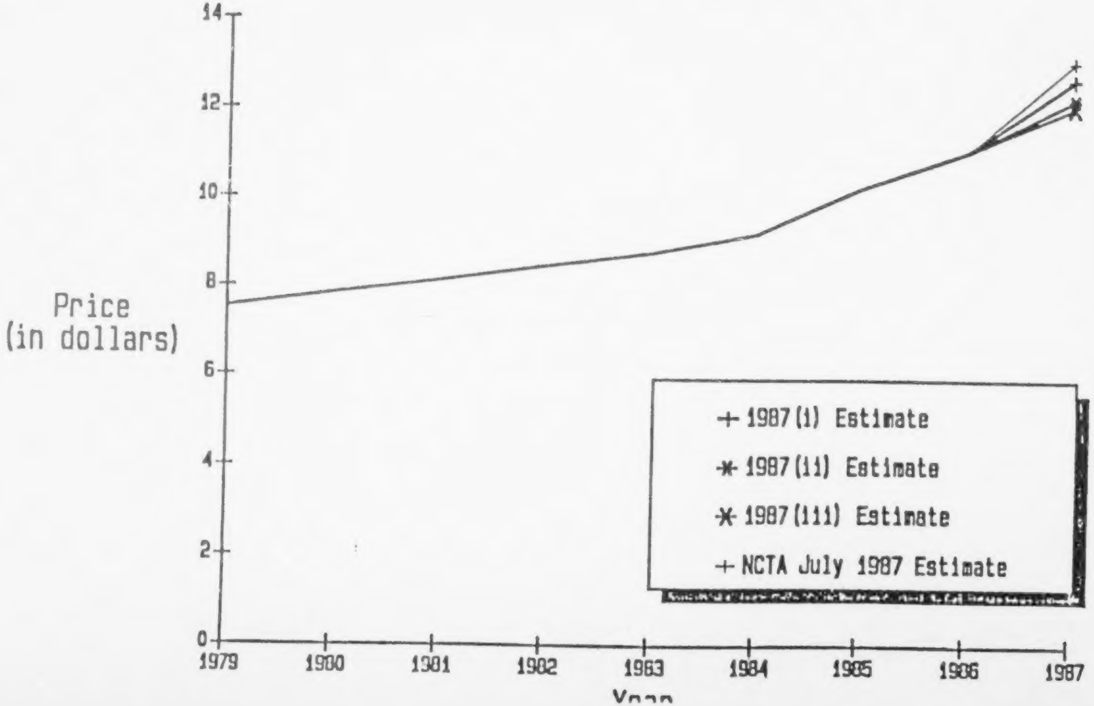
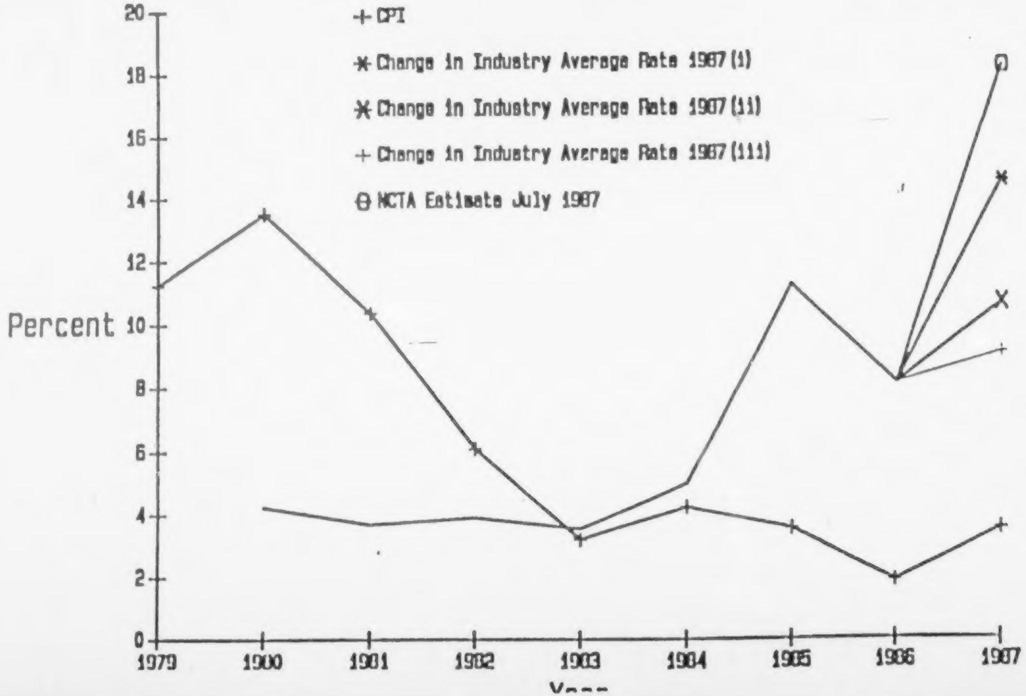


Figure 3: Percentage Increase of the Industry Average Basic Rate Using Different Estimates of the 1987 Industry Average (1979-1987)



## Appendix A1

| Rate Increase (Percentage) | Cost/Price Ratio | | | | | |
|---|---|---|---|---|---|---|
| | 1/1.5 | 1/2 | 1/3 | 1/4 | 1/10 | 1/20 |
| 1 | 3 | 2 | 1.5 | 1.3 | 1.1 | 1.1 |
| 10 | 30 | 20 | 15.0 | 13.3 | 11.1 | 10.5 |
| 25 | 75 | 50 | 37.5 | 33.3 | 27.8 | 26.3 |
| 50 | 150 | 100 | 75.0 | 66.7 | 55.6 | 52.6 |
| 75 | 225 | 150 | 112.5 | 100.0 | 83.3 | 78.9 |
| 100 | 300 | 200 | 150.0 | 133.3 | 111.1 | 105.3 |

To read this table, the first column represents various rate increases. Reading horizontally for each respective rate increase are the percent reductions in market penetration required to make the rate increase unprofitable. For example, a 10 percent rate increase would be unprofitable if it were to induce a 20 percent reduction in market penetration with a cost/price ratio equal to 1/2. (20 = (10/[1 - (1/2)]) = (10/[1 - (vc/p)]).

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EXHIBIT O

September 18, 1987

## IMPACT OF THE CABLE ACT ON FRANCHISING AUTHORITIES AND CONSUMERS

The National League of Cities (NLC) has compiled the results of a survey sent to cable regulators around the nation in July. The purpose of the survey was to begin the process of assessing the impact of the Cable Communications Policy Act of 1984 on regulation of the cable television industry.

### SAMPLE

Responses were received from 233 franchising authorities and covered 274 franchises and 4,681,318 subscribers. While the respondents were primarily municipal franchising authorities, a small number of state (8) and county (33) franchises were also included in the sample.

The average number of subscribers for each cable system was 22,615 and the median number was 12,000. The systems represented in the sample were primarily urban (42.4 percent) and suburban (51.9 percent). Rural communities made up only 5.6 percent of the sample, suggesting that the data does not reveal much about current cable conditions in small communities in isolated areas of the country.

### RATES

Since deregulation took effect on December 30, 1986, 82.6 percent of the cable operators covered by this study increased their rates. However, the significance of this number is diminished by the fact that 40.4 percent of the time the increases in basic service rates were accompanied by increases in the number of services included in basic service. In most cases, these increases in the services provided were considered to be equivalent in value to the rate increase.

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Thus, there was clearly an effective increase in basic service rates in 42.3 percent of the cases (i.e., increased rates and no additional services or increased rates and reductions in the number of services). In these cases, there was a counterbalancing reduction in pay service rates in only 17.3 percent of the cases.

The average rate increase in situations where there was an effective increases in rates was 27.5 percent (the median was 18.5 percent).

In 14.4 percent of the cases, the cable operator did not change basic service rates. Only in 2 percent of the cases were basic service rates actually reduced.

Basic Service. In 16.9 percent of the cases the number of basic service tiers was reduced following deregulation. In 80.8 percent of the cases, the number of basic service tiers was not changed, while in 2.3 percent of the cases the number was increased.

(With respect to the smaller (but more relevant) sample of 91 systems where two or more basic service tiers were provided before deregulation, the number of basic service tiers was reduced in 40.6 percent of the cases, unchanged in 56 percent of the cases, and increased for 3.3 percent of the systems.)

Before deregulation, 57.7 percent of the cable operators covered by the survey provided one tier of basic service, 25.7 percent provided two, 11.3 percent provided three, and 5.4 percent provided four or more. After deregulation, there was a clear tendency to collapse multiple tiers of basic service into a smaller number of basic service tiers: in a much greater percentage of the cases -- 71.2 percent -- there was only one tier of service (18.1 percent provided two tiers, 6.2 percent provided 3 percent, and 4.0 percent provided 4 or more).

After deregulation, the average number of services included in basic service increased from 24.6 to 30 channels (the median also showed an increase, going from 24 to 28 channels of programming).

## SUBSCRIBER SATISFACTION

The survey results on subscriber satisfaction do not provide a clear indication of whether the Cable Act has helped or hurt consumers. In a majority of cases -- 58.3 percent -- no change in the level of subscriber satisfaction was reported. In 22 percent of the cases, however, it was reported that subscriber satisfaction actually went up after deregulation. On the other hand, in an almost equal percentage of the cases -- 19.7 percent -- the level of subscriber satisfaction was judged to have declined.

## REPOSITIONING AND PROGRAM CHANGES

In a large percentage of cases -- 73.5 percent -- cable operators were reported to have repositioned channels by changing their numbers. Further, where the franchise included valid programming requirements (44.9 percent of the franchises covered by the survey), cable operators were reported to have made unilateral changes in programming without the approval of the franchising authority in 33.5 percent of the cases while no unilateral changes were made in 66.5 percent of of the cases.

## FRANCHISE COMPLIANCE

In 26 percent of the cases, the cable operator was reported to be in total compliance with the franchise. In the remaining 74 percent of the cases, the degree of compliance ranged from technical to substantive violations. In 47.9 percent of the cases, the franchise violations were primarily technical in nature and the operator was considered to be in substantial compliance with the franchise. In 19.2 percent of the cases, there were significant violations and in 6.8 percent of the cases non-compliance was extensive.

## TECHNICAL STANDARDS

In 82.9 percent of the cases, the cable system was subject to technical standards of some sort. Only 31.3 percent of the franchises which included technical standards have been amended to include the guidelines established by the Federal Communications Commission (FCC) in 1985. The remaining had locally-established standards (46.2 percent) or some other type of standard (22.5 percent).

## CONTRACT MODIFICATION

The contract modification provisions of the Cable Act were invoked in only 10.7 percent of the cases. In the 22 cases in which section 625 was used to seek amendments to the franchise, the proposed changes were approved in whole in 37.5 percent of the cases and in part in 50 percent of the situations, for a total of 87.5 percent. The franchising authority made no changes in the franchise in only 12.5 percent of the cases.

## FRANCHISE FEES AND TAXES

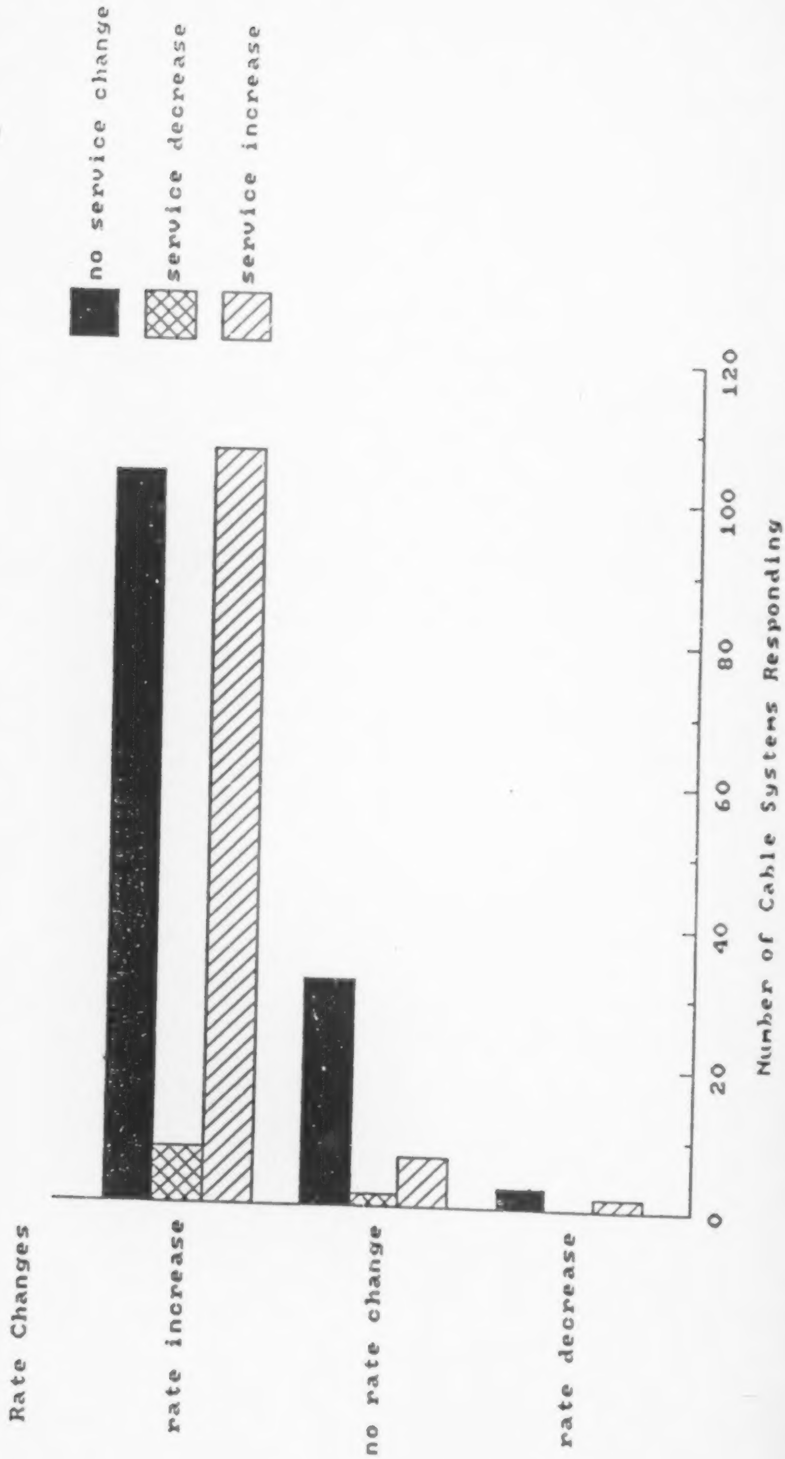
The franchise fee rate has remained the same since the effective date of the Cable Act in a substantial majority of the cases -- 75.1 percent. The fee rate increased in 22.2 percent of the cases, and decreased in 2.7 percent of the franchises. In 88.1 percent of the cases, the franchise fee was levied on all revenues derived from the operation of the cable system. In 7.8 percent of the cases, it was assessed only on basic service revenues, and in 4.1 percent of the cases some other indicator was used (e.g., an annual per-subscriber charge).

For 65.7 percent of the franchises where a percentage franchise fee was used, the rate was 5 percent (or more in a handful of cases). In the other cases, the rate was 3 percent for 23.6 percent of the franchises, 4 percent in 5.1 percent of the cases, and 1 percent for 4.1 percent of the franchises. A small number (0.5 percent in each category) had no franchise fee, a 2.5 percent rate, or a 4.5 percent rate. The average rate for franchise fees was 4.3 percent.

License fees were paid by 51.3 percent of the cable operators to the franchising authority, property taxes by 69.4 percent, utility taxes by 14.3 percent, and sales taxes by 20.7 percent.

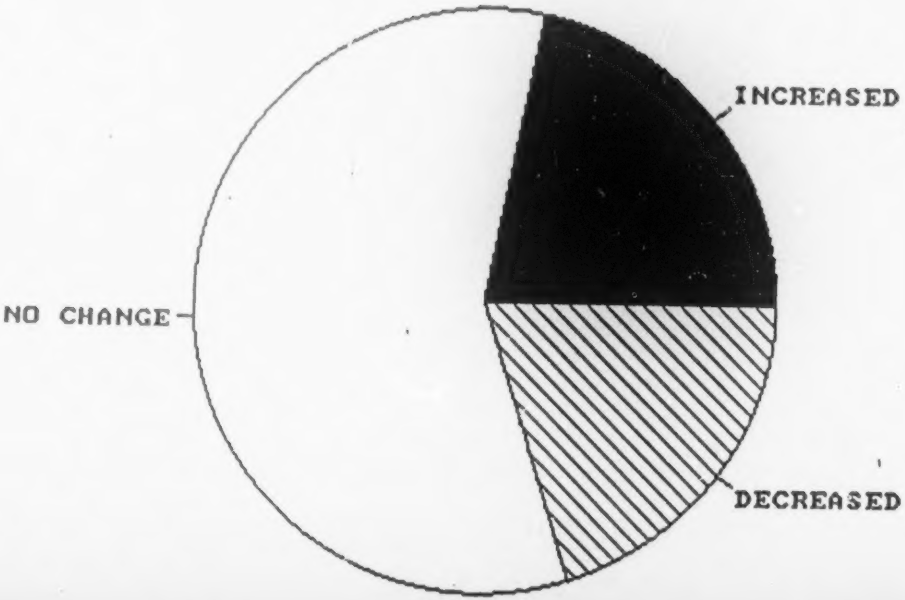
## ACCESS SUPPORT

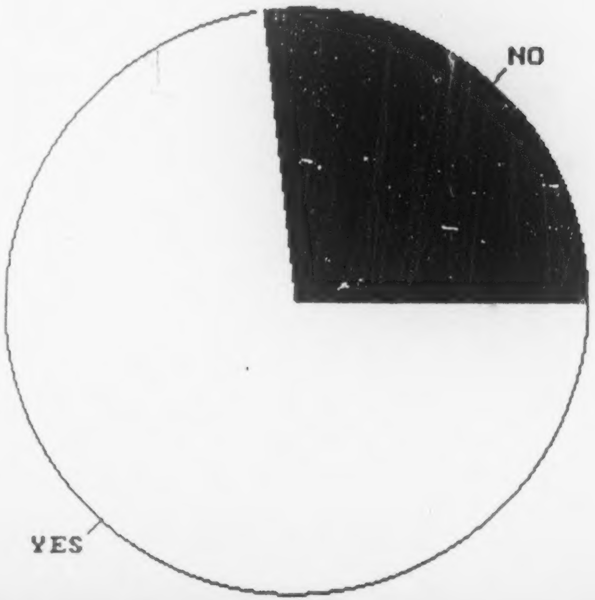
Since the Cable Act's effective date, there has been no change in the operator's financial support for public, educational, and government access in 69.6 percent of the cases. In 15.7 percent of the cases, such financial support has increased while it has decreased in 14.7 percent of the cases.



RATE CHANGES SINCE DEREGULATION

## SUBSCRIBER SATISFACTION AFTER THE CABLE ACT





CHANNEL REALIGNMENT:

Has the cable operator repositioned channels?

# CABLE TV

## Our survey shows some 60 percent of our readers are hooked up and watching. But do they like what they see?

### The channels

What does cable television have to offer that regular TV doesn't? We asked subscribers to judge the quality of the programming on the major cable channels, both pay and basic. You'll find the Ratings on page 551.

### The service

Cable systems' service and rates vary widely around the country. Is cable worth the $275 a year that the average reader pays? How does your system measure up? We contrast three pairs of local cable companies from three parts of the country on page 552.

### The issues

Cable continues to flourish and to distinguish itself from "regular" TV, yet it remains mired in sticky legal issues: charges of monopoly, interlocking ownerships, runaway deregulation. These issues affect what you see and what you pay. See page 553.

Sometime this year, cable TV will overtake broadcast TV: More than half of all American homes that have TV sets will get their picture through privately owned wires instead of over the air.

It's been a banner year for cable TV in other ways, too. This year, the industry expects to top $1-billion in advertising revenues for the first time—a fraction of the ad money that broadcast TV rakes in, but a milestone nonetheless. It's the first full year that Congress has allowed rate deregulation; cable companies, not municipalities, now determine how much to charge for basic service. And this year, the Government gave cable TV a new and hefty weight in the formula used to calculate the Consumer Price Index—a bureaucratic solemnization, so to speak, of cable TV's coming of age.

Cable TV has taken 40 years to entrench itself this firmly in America's living rooms and consciousness. In the beginning, cable TV wasn't even called that. It was community-antenna television, or CATV, and its sole purpose was to bring broadcast channels to places that otherwise couldn't get them.

In 1948, an appliance salesman named John Walson strung a cable—a stretch of twin-lead antenna wire—from a mountaintop aerial to his store below in the Appalachian coal-mining town of Mahanoy City, Pa. The wiring was strictly a ploy to sell television sets, then a new-fangled invention. Walson put three sets—one tuned to each network—in his store window and delighted passersby with shows pulled in from Philadelphia, almost 90 miles away. The TV sets sold like hotcakes, but buyers demanded to be hooked into the antenna since their sets were useless without it. The appliance salesman obliged, for a monthly fee—and cable TV was born.

CATV systems sprouted around the country. But law and technology presented two formidable obstacles.

The Federal Communications Commission, at the behest of moviehouse owners and television networks, clamped severe regulatory curbs on the movies and sports that cable TV could carry and forbade cable from carrying advertising. Moviehouse owners and television networks had recognized the new technology as potential competition when some CATV systems started "importing" distant stations for their subscribers. As part of the campaign against cable, those interests lobbied the FCC for protection, raising the spectre of eventual "pay TV" for all Americans.

The growing cable industry battled back in court and before the FCC. By 1980, the regulatory curbs were overturned.

Meanwhile, technology had caught cable TV in an~~other sense.~~ In the early days of cable, the way to relay distant signals was with microwaves transmitted and received with ground-based antennas. That sort of transmission worked well but wasn't practical for long distances. *Home Box Office*, developed in the early 1970s, first transmitted from the top of a skyscraper in New York City and reached only into Pennsylvania with its signal—clearly limiting any visions of large-scale, national cable networks.

When RCA launched its Satcom I communications satellite in 1975, the picture brightened considerably. A cable channel like *HBO* could beam its microwave transmissions to Satcom and relay them back to virtually anywhere on the ground. Dish antennas at local cable systems could pluck the signals from the air, then amplify them and shunt them over coaxial cables directly to subscribers' television sets. Nationwide distribution of cable channels became a reality.

*HBO* signed on to Satcom in 1975. The industry never looked back. Today, nine satellites orbit the Earth, beaming more than 50 cable channels to the 7800 cable systems that dot the U.S. The programs range from TV dramas that first aired more than 30 years ago to the most contemporary of rock videos. They include the flatly commercial, such as nonstop home-shopping. And they include a good deal of programming that has difficulty finding a home on broadcast channels supported solely by advertising. Specials based on CONSUMER REPORTS have appeared on *HBO*, for example, and CU is currently developing children's programming for *The Disney Channel*.

If the channels and their programs are cable TV's product, the local cable systems are the pipeline. On our 1986 Annual Questionnaire, we asked CONSUMER REPORTS readers to rate both. Nearly 150,000 subscribers, 9 in 10 of them current cable customers, responded. They detailed their life with cable TV—the channels, the service, the rates, the changes that the medium has wrought at home. Much of this report, including our Ratings of the most popular cable channels, is based on their answers.

## Readers get hooked up—and get hooked

The TV habits of CONSUMER REPORTS cable customers differ from the national norm in a couple of important ways. Our readers, who are largely suburban and well off, subscribe to cable TV at a high rate: 60 percent of our readers subscribe, but only about 50 percent of all Americans do.

But readers' families watch less TV than average—about 30 hours a week compared with the national average of 50 or 60 hours. So our survey results, while they give a clear picture of a typical reader's TV habits, may not translate well to the typical American's TV habits.

Still, cable TV has had the same effect on our readers that it has had on most folks. Being hooked up makes you watch more television, close to half our readers say.

How do you make room in a busy life for all those new channels? The majority of our readers have curtailed other leisure-time activities, like going to the movies. About one in four now reads less. Concerts, hobbies, and other pastimes have also suffered, but to a lesser extent.

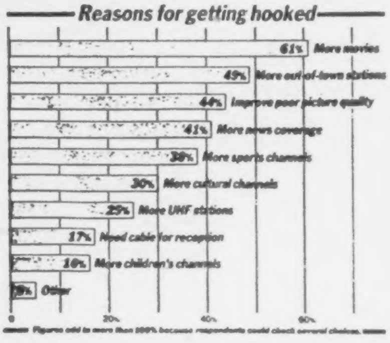
Most of those who took part in our survey were seasoned observers, having been hooked up longer than two years. Most also received at least one pay channel like *HBO* or *Showtime*, which costs perhaps $10 or $12 a month over the basic rate.

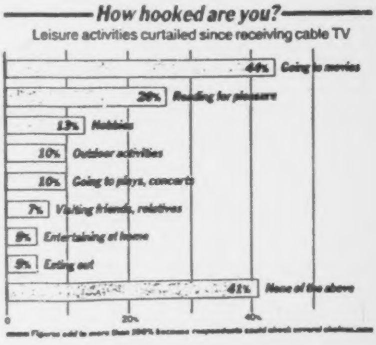
Each month the average reader writes out a $23 check to the cable company, a fee that may have gone up this year with rate deregulation. Add up the checks for a year, and you could buy a basic video cassette recorder or rent quite a few feature films if you already own a VCR.

So why sign up for cable?

Most readers, we learned, don't really need cable for reception: Only one out of six told us that watching broadcast TV was "impossible" without cable, though a substantial minority—44 percent—wanted the improved picture that cable could deliver in their area.

The main reason for taking cable: more movies. Readers likewise relished all the other extra programming that cable brings, as the graph below shows. Almost half wanted to get the so-called superstations—ordinary TV from out of town. All told, our cable customers usually receive at least 10 channels more than they can get with an antenna.





Charts by Corinne Abbazia Hekker

# Cable TV: The channels

USA NETWORK
HSC
HOME SHOPPING CLUB
A&E

It's no secret that ABC, CBS, and NBC have been losing audience share. The percentage of viewers who were watching the networks in prime time shrank by about 20 percent between 1977 and 1985, according to advertising-industry data. The networks' loss—part of it, at least—is cable TV's gain. But the days of easy growth for cable TV are over.

Apart from cities slow to approve cable systems—New York, Philadelphia, and Washington, D.C., are three—most of the areas that will ever be wired for cable have already been wired. Now, the industry can grow mainly by selling cable to people who have so far chosen not to subscribe. To lure them—and to hold onto its 43 million current customers—cable must offer more, better, and different programming than what you find on "regular" television.

So the industry has begun to produce more and more of its own programming. Pay channels, which charge a monthly fee but carry no advertising, can use their cut of that fee to help finance their programming. *HBO*, for instance, takes a bit more than half of what the local cable company charges you, the subscriber.

Each "basic" cable channel—channels included as part of the standard cable service—earns revenue from commercials and from monthly fees paid it by the cable-system operators. Such fees range from 5 to 25 cents per household. The nickels and quarters add up. Last year, basic channels spent more than $1-billion on their programming, much of it on original material.

Cable's strongest suit was supposed to have been "narrowcasting"—the medium's ability to cater to specific interests and audiences that broadcast stations consider too limited. Cable could take a chance on new ideas, it was reasoned, because it has virtually unlimited channel capacity and lower production costs. Where broadcast TV carried sitcoms, cable could carry opera; where broadcast TV carried football, cable could carry chess.

The promise of programming with something less than mass appeal dimmed when the failure of certain channels (*CBS Cable* and *The Entertainment Channel*, in particular) showed that even cable channels need a sizeable audience to remain economically viable. But cable is still trying, with channels like *The Fashion Channel* and *Black Entertainment Television*. Such channels carry a volume of special-interest programming you'd never see on broadcast television.

## Channels and choices

Here's a rundown of the kinds of channels you can expect to find as you flip through the dial:

**Pay movie.** These channels' staple is fairly recent films, unedited and uninterrupted by commercials. *HBO* is the biggest by far, with almost three times as many subscribers as its rival *Showtime*. Both air scores of movies every month (with some overlap), and both offer occasional concerts and comedy specials. *HBO* also covers sports, like the Wimbledon tennis tournament and World Championship Boxing.

*Cinemax*, a sister to *HBO* (both are owned by Time Inc. and share films) pitches its movies to a younger, "yuppier" set, a spokesman said. *Festival*, a new *HBO* sibling, will show movies that are rated G and PG, not R. *The Movie Channel*, a sister to *Showtime* (both are owned by Viacom, an entertainment conglomerate), shows only movies, old ones included. *American Movie Classics* features just that.

**Cultural.** These channels aim for the highbrow. The movies they show are apt to be foreign films or other repertory-house fare. *Bravo*, a pay channel, airs theater, opera, music, and dance as well. *Arts & Entertainment*, a basic channel, imports similar programming, including series from the British Broadcasting Corporation.

**Sports.** Sports have long been a mainstay of broadcast TV, and they're found all over the cable dial. Ted Turner has promoted the Atlanta Braves as "America's team" on his superstation *WTBS*. *The Nashville Network* shows tractor pulls. Some of the channels devoted to sports are pay channels. *ESPN*, a basic channel, covers everything from cheerleading championships to yacht racing. Its coverage of the America's Cup live from Australia last winter helped turn that elite activity into a spectator sport for the first time. *ESPN* truly ascended to the big time when it signed a deal to cover NFL Sunday football this fall.

**Children.** *The Disney Channel*, a pay channel, shows a mix of original films, new features and series, and old-time favorites from the Disney Studios. *Nickelodeon*, a basic channel, offers reruns along with new programming—talk, cartoons, and educational game shows. Both channels try to present shows that the entire family can watch together.

**Music.** *MTV: Music Television* pioneered the music video and offers rock videos, concerts, and related programs 24 hours a day. Other formats presently offered include country and western from *The Nashville Network* and soft rock from *VH-1 (Video Hits One)*.

**News and weather.** Ted Turner's *Cable News Network (CNN)* bills itself as "the world's most important network." The channel offers news and features 24 hours a day, often filling gaps in coverage left by the networks (live, gavel-to-gavel coverage of the summer's Iran/Contra hearings, for instance). A spinoff service, *CNN Headline News*, gives a fast-paced news update every half-hour. The *Financial News Network (FNN)* covers business and the stock-market beat. *The Weather Channel* prognosticates.

**Special audience.** *Lifetime* features shows on health, fitness, fashion, and family, aimed at a female audience. *The Playboy Channel* aims at men, with soft-core "adult entertainment." (That channel is offered on relatively few systems, which generally will provide subscribers with a lock-out device to limit who watches.) Other special-audience channels include *The Discovery Channel* (it features programs on science and nature), *Black Entertainment Television*, and *National Jewish Television*.

**General audience.** These cable networks appeal to the broadest audiences with diverse programming—movies, action series, sitcoms, sports. Cable networks include *USA Network* and *CBN Cable Network*, owned by the Christian Broadcasting Network. (Three-fourths of *CBN's* programming is nonreligious fare, especially reruns of old television series.)

**Superstations.** The "super" in superstations refers to their wide reach, not to anything special in their programming. They are ordinary independent broadcast stations, piped in from out of town. They include Atlanta's *WTBS*, Chicago's *WGN*, and New Jersey's *WWOR*. If you come originally from their broadcast area, the local news and announcers' accents may make you homesick. Look for lots of sports, syndicated shows, and old movies.

**Public affairs.** *C-SPAN* broadcasts Congressional hearings, press conferences, panel discussions, and call-in shows with public officials and newsmakers. About one-fifth of the country's cable systems also offer "public access" channels that televise council meetings and other area events such as Little League games, festivals, even homework hotlines.

**Home shopping.** More than a half-dozen channels devote themselves to selling—essentially, nonstop direct merchandising—and others (such as *The Travel Channel*) use home-shopping as part of their appeal. On some, personable hosts demonstrate the goods—cubic zirconium rings and Italian glass figurines are hot—and chat up callers on the air. Others resemble endless low-budget commercials, with plenty of "buy now—this offer won't be repeated" incentives. Cable operators have good reason to offer shopping channels: They typically pocket a 5 percent sales commission on the orders.

**Pay-per-view.** Cable systems with PPV show recent films when they first appear in videocassette, typically six to nine months before they appear on the pay-movie channels. For about $5, the company sends a movie to your TV at a specified time. Such channels also offer sports and other specials. So far, relatively few subscribers can get PPV, which requires "addressable" circuitry so operators can control channels to individual homes.

## *And the envelope, please*

Our Annual Questionnaire listed the biggest cable channels and asked readers to rate them. We expected readers to be more critical of pay channels than basic channels. In general, they were. After all, pay channels do cost extra money.

The four big pay-movie channels—*Cinemax*, *HBO*, *Showtime*, and *The Movie Channel*—drew a lukewarm response. The survey's lowest marks went to *Playboy*. Indeed, more than half our readers who'd sampled the channel have since dropped it.

But a pay channel, the family-oriented *Disney Channel*, bested every other pay and basic service—by quite a margin.

Among the 15 "free" channels rated, *CNN* and its sidekick *Headline News* led the way. News is apparently a widespread taste and much appreciated.

Music, however, has a narrower appeal among our readers (typical age: 42). They rated *The Nashville Network* and *MTV* at the bottom of the heap.

The Ratings also note which channels appealed to any special audience among our readers. And we asked readers to nominate particularly distinctive channels—those with shows or movies not usually seen on other cable or broadcast channels. Only 5 of the 23 channels garnered an appreciable number of votes for distinctiveness. They included the three top-rated pay channels and the lowest-rated one, *Playboy*. Only one basic channel made the list—*Arts & Entertainment*. Significantly, none of the big pay-movie channels did.

Indeed, the pay-movie channels have been fretting over their lack of distinctiveness. Competitors are trying harder than ever to avoid showing the same titles. Rivals *Showtime* and *HBO* have each signed exclusive movie deals with different studios. *Showtime* will buy films only from Cannon, De Laurentiis, Touchstone, and Paramount (the last was recently stolen away by *HBO*, in a new exclusive agreement that takes effect in mid-1988). As a matter of policy, *Showtime* does not deal with studios that sell to *HBO*. *HBO's* contracts cover Columbia, Orion, and Tri-Star. Warner and 20th Century Fox also supply *HBO* but have no special agreement. *HBO* says it has "de facto" exclusivity from the two, since *Showtime* now avoids their films.

Such arrangements will mean a minimum of duplication across the channels this fall (though siblings *HBO* and *Cinemax* will continue to share films, as will *Showtime* and *The Movie Channel*). You can expect "Hannah and Her Sisters" (from Orion) and "The Color Purple" (from Warner) to turn up on *HBO*, not *Showtime*. Expect "Crocodile Dundee" and "Top Gun" (both from Paramount) only on *Showtime*. If you want to see all those movies, you'll just have to pay for both channels.

Of course, you could also rent the movies if you have a VCR, an invention that has seriously stunted the growth of pay-movie channels. You can rent three or four movies for the price of the monthly fee. And many public libraries loan out movies for free.

To help fend off defections, the big pay channels now stress their compatibility with VCRs and encourage subscribers to "time-shift" as they sleep. *The Movie Channel*, for instance, runs a "VCR Theater" at 3 each morning.

Our survey revealed that readers do tape a good deal from cable. Most readers own a VCR, and most tape a movie at least once a month.

## Guide to the Ratings

Listed by groups; within groups, listed in order of overall quality score based on responses to CU's 1986 Annual Questionnaire. Differences of 3 points or more in score are meaningful.

① **Channel.** Pay channels were rated by at least 2800 of their current and former subscribers; most were rated by more than 15,000. Basic channels were rated by at least 25,000 of their current subscribers; most were rated by more than 50,000.

② **Type.** CU's categorization of a channel's typical programming.

③ **Overall Score.** Readers rated overall quality on a five-point scale from excellent to poor. We've summarized those judgments as the Overall Score. Had everyone judged a channel excellent, its score would have been 100; had everyone judged it poor, its score would have been 0. Results pertain only to CONSUMER REPORTS readers, who generally watch less television than Americans overall.

④ **Readers' rating.** The three-part bars give a breakdown of how readers rated channels on the excellent-to-poor scale.

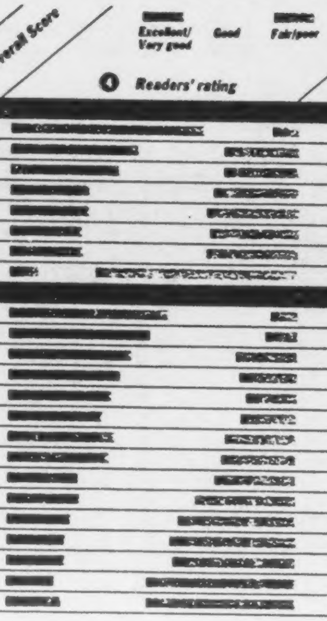
⑤ **Distinctive.** Readers indicated the channels "whose shows or movies are so unique you'd be unlikely to see them on other cable or broadcast channels." For the channels checked, roughly one-third or more judged them distinctive.

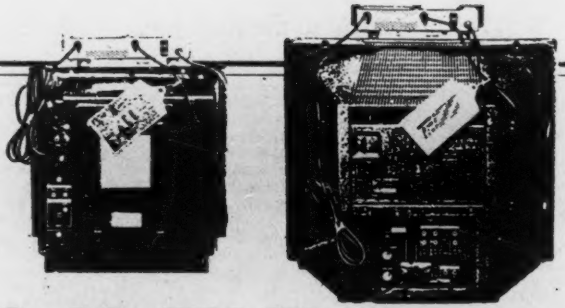
⑥ **Special appeal.** If M is listed, men rated the channel's quality significantly higher than women did—generally by 5 or 6 points in Overall Score; if W is listed, the opposite occurred. If O is listed, readers aged 45 and over rated the channel significantly higher than younger adults did; if Y is listed, the opposite happened. If C is listed, at least half the respondents who have children at home called the channel a favorite with their youngsters.

# Ratings

## Cable-TV Channels

| ① Channel | ② Type | ③ Overall Score | ⑤ Distinctive | ⑥ Special appeal |
|---|---|---|---|---|
| ***Pay channels*** | | | | |
| ***The Disney Channel*** | Children | 70 | ✓ | W,Y,C |
| ***Bravo*** | Cultural | 56 | ✓ | O |
| ***American Movie Classics (AMC)*** | Pay movie | 54 | ✓ | W |
| ***Home Box Office (HBO)*** | Pay movie | 49 | — | Y |
| ***Showtime*** | Pay movie | 48 | — | Y |
| ***Cinemax*** | Pay movie | 47 | — | — |
| ***The Movie Channel (TMC)*** | Pay movie | 47 | — | — |
| ***The Playboy Channel*** | Special audience | 27 | ✓ | M |
| ***Basic channels*** | | | | |
| ***Cable News Network (CNN)*** | News and weather | 64 | — | — |
| ***CNN Headline News*** | News and weather | 62 | — | — |
| ***Arts & Entertainment (A&E)*** | Cultural | 56 | ✓ | W,O |
| ***ESPN*** | Sports | 56 | — | O |
| ***WTBS*** | Superstation | 55 | — | — |
| ***WGN*** | Superstation | 54 | — | — |
| ***The Weather Channel*** | News and weather | 54 | — | — |
| ***Nickelodeon*** | Children | 52 | — | W,Y,C |
| ***USA Network*** | General audience | 48 | — | — |
| ***Lifetime*** | Special audience | 46 | — | W |
| ***Financial News Network (FNN)*** | News and weather | 43 | — | O |
| ***C-SPAN*** | Public affairs | 42 | — | O |
| ***CBN Cable Network*** | General audience | 42 | — | W |
| ***The Nashville Network*** | Music | 36 | — | O |
| ***MTV*** | Music | 35 | — | W,Y |





# Cable TV: The service

When subscribers gripe about their cable system, it's a good bet they're griping about unreliable service. The most sophisticated cable operation doesn't amount to much if you're frequently blacked out or if you can't get the company on the phone.

Three out of five readers in our cable-TV survey reported that they had experienced one or more service disruptions in the past year; one in five, in the month before the survey. An unlucky one in 10 said they had endured more than a half-dozen such disruptions.

Judging from our readers' most recent problems, service outages tend to be fairly short. Half lasted three hours or less. Still, about one in eight of the outages lingered for two days or longer. Worse, all channels on the system were usually affected.

What about picture quality when the system is up and running? Nearly all readers were satisfied. Yet close to half also re-

## How cable service compares in three areas

### Virginia suburbs

| | **Media General Cable** Fairfax County | **Metrocable TV** Arlington County |
|---|---|---|
| Start-up year | 1983 | 1978 |
| Subscriber count | 139,500 | 37,000 |
| **Costs** | | |
| Hookup (cable-ready set) | $39.95 [1] | $39.95 |
| Basic service (monthly) | 12.95 [2] | 15.25 |
| *HBO* (monthly) | 9.95 | 11.50 |
| **Channels** | | |
| System capacity | 120 | 36 |
| Included in basic service | 77 | 31 |
| Pay channels offered | 10 | 5 |
| Pay-per-view offered? | Yes | No |
| **Survey findings** | | |
| Outage of 2 days or longer | 4% | 8% |
| Very satisfied with picture quality | 64% | 45% |
| Picture quality variable | 22% | 47% |
| Hard to reach company | 22% | 39% |
| Had billing problem | 21% | 28% |
| Overall satisfaction (on scale of 0 to 100) | 71 | 57 |

*[1] $10 less if house has aerial*
*[2] "Limited" service for $4.95 a month includes 43 channels.*

### New York City

| | **Manhattan Cable TV** Lower Manhattan | **Paragon Cable Manhattan** [1] Upper Manhattan |
|---|---|---|
| Start-up year | 1967 | 1966 |
| Subscriber count | 228,000 | 124,000 |
| **Costs** | | |
| Hookup (cable-ready set) | $29.95 | $19.95 |
| Basic service (monthly) | 13.95 | 13.95 |
| *HBO* (monthly) | 12.95 | 13.95 |
| **Channels** | | |
| System capacity | 35 | 26 |
| Included in basic service | 31 | 22 |
| Pay channels offered | 3 | 5 |
| Pay-per-view offered? | No | No |
| **Survey findings** | | |
| Outage of 2 days or longer | 22% | 15% |
| Very satisfied with picture quality | 34% | 31% |
| Picture quality variable | 55% | 58% |
| Hard to reach company | 47% | 52% |
| Had billing problems | 27% | 38% |
| Overall satisfaction (on scale of 0 to 100) | 53 | 50 |

*[1] Company formerly owned by Group W Cable; survey done before sale to Paragon.*

### San Diego

| | **Cox Cable San Diego** South of river | **Southwestern Cable TV** North of river |
|---|---|---|
| Start-up year | 1961 | 1964 |
| Subscriber count | 280,000 | 103,000 |
| **Costs** | | |
| Hookup (cable-ready set) | $30.00 [1] | $30.00 [1] |
| Basic service (monthly) | 15.70 | 14.84 |
| *HBO* (monthly) | 10.95 | 11.95 |
| **Channels** | | |
| System capacity | 35 | 35 |
| Included in basic service | 34 | 27 |
| Pay channels offered | 7 | 6 |
| Pay-per-view offered? | Yes | Yes |
| **Survey findings** | | |
| Outage of 2 days or longer | 5% | 5% |
| Very satisfied with picture quality | 36% | 41% |
| Picture quality variable | 40% | 38% |
| Hard to reach company | 62% | 53% |
| Had billing problem | 41% | 27% |
| Overall satisfaction (on scale of 0 to 100) | 54 | 60 |

*[1] $15 if house is already wired.*

Based on information from companies and CU's survey findings of readers' experiences in 1985-86. Figures for those finding it "hard to reach company" are based on only those who tried.

ported that picture quality varied from channel to channel, with some channels looking worse than others.

A sizable minority—one in three—complained about the billing. Their biggest peeves: the high cost of adding or dropping pay channels, confusing or inaccurate bills, and the hard-to-fathom package deals that their company promotes.

Most readers told us that they had tried to reach their cable company in the past year. Easier said than done. Half of those who called said that getting through was downright difficult—a poor record for a service-oriented business.

Readers had a chance to sum up their overall satisfaction on a five-point scale. One-sixth called themselves "dissatisfied" or "very dissatisfied." Only one-third gave the company high marks, saying they were "completely" or "very satisfied." Judging from past surveys of other services, that's a lackluster showing.

### A tale of six systems

But perhaps lackluster service is what you get when a company enjoys a monopoly. Fewer than 1 percent of cable-TV systems operate with any direct competition. If you want—or need—cable, you must get it from the company that holds your area's cable franchise.

The quality of service may be just a matter of where you live. Sometimes the crazy quilt of thousands of cable companies leads to glaring disparities in service from one neighborhood to the next. Alerted by industry experts to areas likely to show such contrasts, we pulled survey questionnaires to take a closer look at three: San Diego, Manhattan, and the Virginia suburbs of Washington, D.C. In San Diego, the San Diego River divides the companies. In Manhattan, it's major crosstown streets. In Virginia, it's the line between Fairfax and Arlington counties.

One of the sharpest differences was the systems' channel capacity. In Arlington, Metrocable offers only 31 channels with basic service. In neighboring Fairfax, Media General offers 77 channels. One of the most sophisticated cable systems in the U.S., Media General includes in its lineup 17 broadcast channels from Washington, Maryland, and Virginia; dozens of cable services; and 10 community channels. The system even boasts a "four-in-one" channel, which displays the three major networks and a Public Broadcasting Service station simultaneously in four quadrants of the screen—a TV junkie's dream. For all that, Media General customers pay $2 a month less than their Arlington neighbors.

Media General started up only a few years ago. Older cable systems, such as those in Manhattan, often lack channel capacity. Old equipment wasn't designed to carry many channels, since there weren't many channels to carry 20 years ago. New York's 21-year-old Paragon system delivers the fewest channels of these six companies—a mere 26; its basic service gives only 22. New Yorkers who live farther downtown get nine more channels from Manhattan Cable, though it's almost as old as Paragon.

Systems cope with limited capacity by letting different channels share the same slot on the dial at different times of day. This spring, Paragon added the highly rated *Arts & Entertainment* channel for its customers—but only from 8 A.M. to 7 P.M. At night, it substitutes a pay-movie service. Manhattan Cable subscribers get to watch *A&E* around the clock. As for pay channels, neither New York system offers *Disney* or *Bravo*, the channels that topped our Ratings. The cable-channel lineup available to Manhattanites is among the most limited we've seen.

San Diego's two systems are even older than New York's. They've kept up with the times, however, each offering 35 channels, including pay-per-view movies. The Cox system includes a few more channels with its basic service than neighboring Southwestern Cable.

How did our readers rate the service of these companies? Fairfax's spiffy Media General system won hands down, at least for the period in 1985 and 1986 that our survey covered. The system's superiority likely reflects itself in residents' eagerness to sign up. About two-thirds of Fairfax's homes subscribe; fewer than half in neighboring Metrocable's territory do so. Readers also reported big differences in picture quality between the Virginia systems. Almost two-thirds of Media General's customers praised its picture with highest marks, but fewer than half of Metrocable's customers did likewise. Virginia readers also judged it appreciably easier to reach Media General on the phone.

By contrast, San Diegans had a far tougher time getting their companies on the line. Cox was especially bad, with 62 percent of the readers who'd tried to call reporting that it was difficult. And Cox's customers had good reason to call: The company had one of the worst scores on billing problems—much worse than its neighbor. New York's Paragon also came off poorly compared with its downtown counterpart.

New York's two cable systems had the longest outages, based on readers' most recent service disruption. (Paragon, however, may have improved under its new management; at the time of our survey, it was owned by Group W Cable.) According to our survey, more than one-fifth of Manhattan Cable customers had experienced outages that lasted two days or longer. Paragon's performance was somewhat better but far from good. Figures from the other systems revealed far fewer disruptions that severe.

# Cable TV: The issues

As cable television gains an ever-stronger foothold in America's homes, an army of cable's critics has begun to muster. Its ranks include consumer advocates, cities, broadcast television (particularly independent and Public Broadcasting Service stations), the motion-picture industry, even the operators of small cable systems, who feel increasingly squeezed by the biggest cable companies.

They contend that cable has grown into a monopolistic "electronic gatekeeper" to half the nation's households; that a handful of corporate giants control programming, service, and prices to their own benefit and to the detriment of the public.

For decades the cable industry has tried to deflect the public's say in its affairs. Cable programs travel into your home over private wires rather than the public airwaves. So the industry has long contended that, under the First Amendment, it should be as free from regulation as newspapers or magazines.

Here's a rundown of the most important issues surrounding the growth of cable:

### Local monopoly or not?

Most cable companies operate under a franchise granted by a city or county government, with local monopolies the usual result (and corruption sometimes a problem, as New York and other cities have learned). In return for the franchise, a municipality can set rules benefiting its citizens—insuring that the company will wire the entire area rather than just the neighborhoods likely to produce the most subscribers, for instance. Franchises also commonly guarantee local-access channels, as well as a share of revenues for the municipality.

Places where two cable companies compete head-to-head are rare. Allentown, Pa., is the largest city in which two companies compete for the same residents' business. The competition there appears to have brought customers better-than-average service and equipment. If the cable conks out after business hours, one of Allentown's systems has "service people on the road till 11 P.M., 365 days a year," its vice president told CU. The other company offers even more: 24-hour service. Both systems offer more than 40 channels (36 is standard in the industry), including a pay-per-view service for recent movies and sports events. And both offer relatively low rates for basic service—about $1 a month less than the industry average. One company also boasts a new, broadcast-quality studio for its local-origination programming.

But Allentown is unusual in that almost every household in the city subscribes to cable—reception otherwise is impossible. Places in which fewer homes subscribe might not be able to support two competing operators.

A city's power to grant a monopoly is being challenged in several cities. In Los Angeles, for instance, a cable operator has sued the city to let it compete against the systems that currently hold franchises. The company argues that wiring a city is like distributing a newspaper and that under the First Amendment a cable company can string wires anywhere it wants. That thinking, taken to its extreme, would permit selective wiring—the "cherry picking" of affluent neighborhoods and the "redlining" of poor ones.

In Springfield, Ore., residents have taken another tack. They've launched an initiative to have their utility board take over their system (now run by Tele-Communications Inc.) and operate it as a utility—or compete against it. They're angered by rate hikes of 50 percent over the past two years.

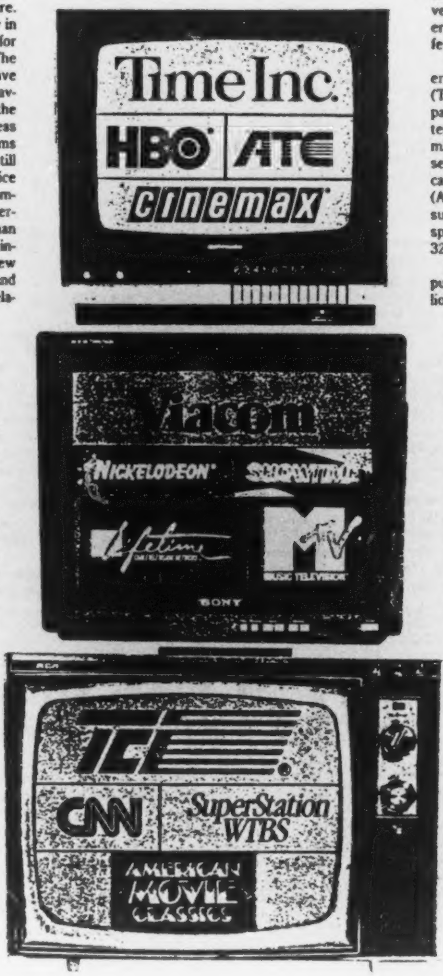
### ***Big versus small***

The cable-TV industry is becoming concentrated in two ways. First, individual cable systems are being bought up by big multiple-system operators. Last year, for instance, a handful of the big companies went on a $9-billion spending spree, scooping up cable systems that serve roughly one in six subscribers in the U.S. Second, the distinction has blurred between the corporations that run the systems and those that produce the programming. Indeed, the biggest system operators often own the very cable channels that their systems show. Those developments are concentrating power over what viewers can watch into fewer and fewer hands.

The biggest multiple-system operator is Tele-Communications Inc. (TCI), based in Colorado. The company owns more than 600 cable systems, which bring TV to some six million households in 44 states. The second-largest operator is American Television & Communications (ATC), a subsidiary of Time Inc. Its subscriber count is 3.5 million, spread over 660 cable companies in 32 states.

The power of systems like that to pull the plug on channels for millions of subscribers has been called "dictatorial" by Jack Valenti, a spokesman for the motion-picture industry. Earlier this year, for example, Tele-Communications Inc. dropped the *PTL Network* from its systems. Likewise, the two million subscribers of the now-defunct Group W Cable (it was broken up and sold last year) were not given a chance even to refuse *The Playboy Channel*, since the company's head reportedly wouldn't carry *Playboy* on any of Group W's systems.

The interlocking ownerships between cable systems and cable channels also affect which channels you see—and which you don't see. Consider Time Inc., which owns cable systems through its ATC subsidiary. Time owns *HBO* and *Cinemax*, two pay-movie channels, as well. Time's cable systems might choose to offer only Time's movie channels and not, say, *Showtime* and *The Movie Channel* (which are owned by another multiple-system operator, Viacom). That's the charge over which a group of subscribers is suing Manhattan Cable TV, a New York cable system owned by Time through its subsidiary.



Manhattan Cable's sole pay-movie channels are *HBO* and *Cinemax*. Subscribers who are suing say they want more choice and assert that the system is deliberately keeping off competitive channels.

According to industry data obtained by CU, more than 90 percent of Time's systems nationwide carry *HBO* and about 75 percent, *Cinemax*. By contrast, fewer than 60 percent of Time's systems carry *Showtime* and only 25 percent, *The Movie Channel*.

A vice president of Manhattan Cable told CU that there was no desire to keep channels off his system. He said that the problem was too few slots on the dial. Eventually, he said, the suit will become moot as his system's channel capacity is expanded. Curiously, Manhattan Cable has managed to find room on its current dial for three home-shopping channels.

Besides owning *HBO* and *Cinemax*, Time has a stake in *Black Entertainment Television*, *Cable News Network*, and *WTBS*. Viacom, whose systems serve one million customers, has a stake in *Lifetime* and owns *MTV*, *VH-1*, *Nickelodeon*, *Showtime*, and *The Movie Channel*. (Viacom, in turn, is owned by a company called National Amusements Inc.) Tele-Communications Inc. has a stake in seven cable channels.

### "Must carry" rules

The Federal Communications Commission, which oversees cable television, wanted to insure that cable customers would still be able to receive local television. So in the mid-1960s the FCC ordered cable systems to carry the broadcast stations in their area. Systems located between big cities had to carry duplicate network stations and a host of independents. The industry considered the rule a burden—channel slots are precious—and fought the "must carry" rule in court. It argued that the First Amendment gives cable systems the right to pick and choose programming, the way a magazine or newspaper picks and chooses articles. Eventually, the original, sweeping rule was declared unconstitutional.

As soon as they could, cable systems around the country started dropping stations. Some were stations that duplicated programming (duplicate Public Broadcasting Service stations were a particular target), but some were local independent stations—stations that often run community programming not available elsewhere. Some of those stations have charged that the cable operators dropped them in order to pick up the local advertising such stations typically carry.

Recently, the FCC adopted a compromise must-carry rule (already under court challenge). The new regulation still requires that certain channels be carried, but it lets cable systems with the smallest channel capacity carry only one noncommercial broadcast channel. Systems with a 50-channel capacity must offer a dozen broadcast channels.

### Deregulation

Congress substantially deregulated the cable industry with the Cable Act of 1984. The act allows cable companies, starting this year, to set their own rates for basic service. (Previously, such rates had to be approved by local governments.) Along with rate deregulation, the Cable Act made the renewal of cable franchises almost automatic. Consumer advocates say that both provisions rob local governments of ways to safeguard the interests of cable subscribers in the price and quality of the service.

Congress intended rate deregulation to occur only in areas where cable companies face "effective competition"—namely, in places where people receive sufficient over-the-air TV. The lawmakers wanted to keep local officials in charge of cable in places where residents have little choice but to subscribe. It fell to the FCC to sort out which communities have good enough reception to warrant deregulation.

The FCC ruled that deregulation could proceed in any place that can get three on-air channels. But the rules the Commission adopted allow for very snowy pictures and a 30-foot high antenna. Further, if as many as half the people can receive broadcast stations only on the clearest days, the area still qualifies for deregulation under the FCC's rules.

Consider Dubuque, Iowa, a city of 63,000 surrounded by 1000-foot bluffs rich in lead deposits. The mountains and metal cut Dubuque's reception significantly. Yet the FCC maintains that the city can get eight broadcast channels. The city's cable administrator says Dubuque barely receives one, which is why more than four of five homes there get cable. "We're a classic example of markets that are truly a captive audience for cable," he said.

Or consider Manhattan, where many people live in the shadows of skyscrapers. Nearly half our survey sample from Manhattan said TV reception was "impossible" without cable—about three times the proportion in the survey overall. Yet cable was deregulated in New York City, as it was in Dubuque and most places. Under the FCC's rules, cable was deregulated for 90 percent of customers.

New York and Dubuque joined other cities in a suit over the FCC's guidelines. A verdict handed down in July requires the FCC to issue new criteria to gauge the quality of local reception, but new rules probably won't be issued soon. ■

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# Report downplays rate increases

## *NCTA study puts average increase in monthly bills at $1.45 since deregulation*

**By John Wolfe**

WASHINGTON—The average cable subscriber's monthly bill increased just 6.7 percent in the first six months following federal rate deregulation, according to a National Cable Television Association-sponsored survey of nearly 600 cable systems serving 16 percent of the nation's cable homes.

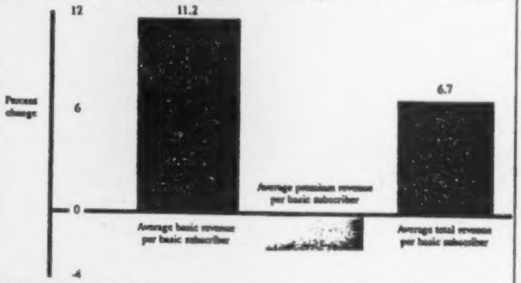
NCTA, working with Arthur Andersen and Co., prepared the report in anticipation of upcoming House Telecommunications Subcommittee oversight hearings on how the cable industry has fared in the wake of the 1984 Cable Act. Those hearings likely will not convene until early next year.

According to the study, previewed by NCTA board members on Nov. 16 and publicly released Nov. 23, basic rates have increased an average 10.6 percent, or $1.26, since last December, but have been offset by an average 2.5 percent decrease in rates for premium services. As a result, average monthly total revenue per subscriber grew by 6.7 percent, from $21.59 to $23.04, NCTA said.

The report confirms what many cable officials predicted would occur. As basic rates went up, many operators eliminated multiple tiers and instead offered an expanded basic service. The number of basic service channels received by the average subscriber increased by 5.9 percent, from 27.3 to 28.9 channels, NCTA said.

For the study, NCTA mailed surveys to 2,577 systems chosen at random; 598, or 23 percent, responded. NCTA said the response represented a "high return rate for a mail survey of this complexity."

Percentage change between December 1986 and June 1987 in average revenue per basic subscriber



NCTA reports that although monthly basic revenue per subscriber increased by approximately 11 percent, premium monthly revenues per subscriber dropped by 2.3 percent. Total monthly revenues per subscriber, reflecting all revenues from subscriber services, grew by 6.7 percent, from $21.59 to $23.04.

But cable adversaries were quick to question NCTA's results. "Their study does not seem to comport with the numbers anywhere else," claimed Cynthia Pols, legislative counsel to the National League of Cities. A recent NLC survey found that rates increased by 27 percent, while Paul Kagan Associates puts the figure at approximately 24 percent, she noted.

"I don't think it will have too much of an impact" on Capitol Hill, Pols predicted. "Too many people will question its validity," she explained, claiming that many operators may not have responded to NCTA's survey because they did not want to present an unfavorable picture to Congress.

"We urged that all systems respond no matter what they had done," countered Cynthia Brumfield, NCTA vice president, research and policy analysis.

NLC's survey "was very different from ours" because it focused only on systems which raised rates without offering additional channels, another NCTA official retorted. The official noted that NCTA's results closely mirror those of the Bureau of Labor Statistics, which would "be much more neutral" than the League. BLS reported a 5.3 percent increase in the average price of cable service for the first six months of 1987.

NCTA's results also suggested that the rate increases "were very well accepted by cable subscribers," Brumfield maintained. Both the number of homes passed by cable and the number of subscribers increased by 3.3 percent from December to June, according to the study, while the penetration of subscribers to homes passed remained constant at 56.7 percent.

Also, basic and premium churn, "which can be considered measures of customer satisfaction with cable, have declined since deregulation went into effect," NCTA said. The average annual basic churn rate reported by participating systems dropped from 20 percent in 1986 to 18.8 percent in 1987.

Many industry officials had claimed that the freedom to raise basic rates would take the pressure off artificially high-priced premium services, and according to the survey, the pay services are rebounding. Brumfield said she was surprised by the "incredible resurgence in premium network subscriptions" in the six months after rate deregulation. Among responding systems, the total premium units sold grew by 3.7 percent, according to the study.

Moreover, the pay-to-basic ratio, which has declined industry-wide over the past couple of years, increased from 81.6 percent to 82 percent for participating systems, NCTA said.

NCTA also noted that since deregulation, the cable industry's investment in plant, equipment and customer service has increased. ■

# Cable-TV Systems, Since Deregulation, Are Selling at Increasingly Higher Prices

By Laura Landro

*Staff Reporter of* The Wall Street Journal

LAS VEGAS, Nev.—Five months after deregulation of the cable-television industry, cable systems are changing hands at increasingly higher prices and industry executives say there is no end in sight.

"It's a supply and demand situation," says John Malone, president of the nation's largest cable company, Tele-Communications Inc. "The industry has good cash flows, people want to expand and there are limited opportunities, so if you want to buy you have to pay these prices."

A half-dozen cable systems with between 50,000 and 450,000 subscribers each have been sold recently at prices ranging between $1,500 and $2,000 per subscriber. The continuing strength of system prices is a dominant topic among executives attending the National Cable Television Association convention, which ends here tomorrow.

"Prices will go higher before they plateau," predicts Paul Kagan, a Carmel, Calif.-based media consultant.

But it isn't just large public companies such as Denver-based Tele-Communications that are in the market now. In addition, "it's the small and medium-sized companies who are propping up prices," says John Waller III, a leading cable-system broker.

Although the big companies are still interested in properties, they seem reluctant to pay top dollar. Trygve Mhyren, chief executive officer of Time Inc.'s 80%-owned American Television & Communications Inc., says, "We wouldn't pay $2,000 (per subscriber) for everything, but we're willing to do it for things that make sense," for example, systems that are geographically contiguous to existing American Television markets. Mr. Mhyren says that since last August his company has bought cable systems serving 80,000 subscribers at prices ranging between $1,200 and $2,000 per subscriber.

## Handsome Profits

Sellers are making handsome profits, even in marginally attractive markets. For example, former Capital Cities/ABC Inc. executive William James last week sold to First Carolina Communications Inc. for $170 million cable systems that he purchased last year for $100 million. The sale price is the equivalent of about $1,700 per subscriber. Executives of Burlington, Vt.-based Mountain Cable are said to be negotiating the sale of their 56,000-subscriber system—acquired for $42 million 2½ years ago—for about $115 million.

A number of major cable-television companies say prices are too high now. William Elsner, chief financial officer of Denver-based United Cable Television Inc. told analysts here that current high prices "took us out of the acquisition business." He said that unless a cable system is in a key geographic area near other United systems, "we aren't going to stretch that far to get it."

Mr. Elsner said it is "tough to make a return" on a $2,000-per-subscriber investment. Cable systems are generally sold on the basis of their cash flow—12 to 13 times cash flow is the going rate—but industry executives often use per-subscriber figures as well.

## Completed Spending

Deregulation has permitted cable systems to increase their cash flow by raising prices to consumers. Cash flow also has benefited because most of the hefty capital expenditures for laying systems have been completed.

John Kornreich, an analyst at Neuberger & Berman, acknowledges that current prices are hard to justify, but he notes that cable systems' cash flow is growing 20% annually because of rate increases. "If the price isn't right for this year, it is for next year," he says. "A lot of smaller players are saying we have a window of opportunity now, we better get in."

Mr. Kornreich notes that buyers are willing to pay high prices even for older systems in economically unexciting areas. For example, Adams Russell Inc. recently outbid about 25 rivals to buy R.R. Donnelley & Sons Co.'s Rockford, Ill., cable system for about $90 million, or about $1,500 per subscriber. Adams Russell also agreed to rebuild the system at a cost of about $200 per subscriber.

"While local economics are important, cable thrives almost anywhere," says Mr. Kornreich.

John Reidy, an analyst at Drexel Burnham Lambert Inc., says an increase in interest rates could damp cable's attractiveness compared with other investments. But, according to Mr. Kornreich, "It would take a big run-up in interest rates" to significantly reduce the appeal of cable systems.

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Rouge plant, notes that, because the system collapsed its tier structure and added VH-1 and American Movie Classics when it raised its basic rate from $10.95 to $14.95 last April, the local daily, *The State Times—Morning Advocate*, bannered its story: "Cablevision to add new channels." "We were waiting for the other shoe to drop and it never did," Michel notes. "The local TV station didn't even do a story on it."

Colony Communications President Charles Townsend sums up the situation neatly for operators in general: "Our business is going gangbusters. We're seeing, on average, a growth of 2 to 4 percent in homes passed, and an increase in basic penetration of a like amount. That, combined with rate hikes, is giving cable systems a revenue growth of about 10 percent, against an average of 5 percent for the Fortune 500 companies."

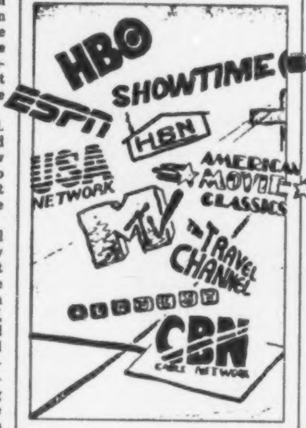
But, he adds, storm clouds lie ahead. "At some point, the homes-passed and basic-penetration growth will slow down. And that's when you'll start to need price increases in the 10 percent range. I think that will happen in three to five years."

To meet this challenge, Townsend says the development of pay-per-view and the local advertising sales market will be essential. Colony is an example of an MSO that essentially has been sitting on the sidelines with PPV, watching it develop, but Townsend observes that it is absolutely essential that operators develop these two revenue streams now, to avoid antagonizing customers later. Colony is going to "go heavily into pay-per-view," he vows, with 75 percent of the company's systems now addressable. Colony should gross $7 million in advertising revenue this year, about 10 percent of total revenues, and Townsend sees ad sales continuing to grow at the present rate of 15 percent to 20 percent a year.

Operators from across the industry seem almost stunned by the way good fortune appears to be smiling on them in this first year of deregulation, but they agree with Townsend that it's important to avoid any pricing and packaging measures that could alienate customers. An instructive example is provided by Cablevision Systems. The large Long Island-based MSO had been characterized before deregulation by "exceptionally low basic rates," and had been compensating in many systems with exceptionally high pay charges, notes Peter Low, director of programming.

In its Norwalk, Conn., system, Cablevision raised its "entry-level" price to $19.95 in March. The system had been charging a steep $14.50 for single pay channels, and that has been reduced to $10, closer to the industry average. As a result, the single-pay category has grown by 25 percent since March, the month the lower price was instituted, Low states. In some systems, Cablevision has attempted to grow customers out of single pay by offering a choice of The Disney Channel or American Movie Classics "for a nominal fee," Low adds.

Cablevision considers the changes to be an unqualified success, he notes, because basic disconnects have been "nominal, in the 1 to 2 percent range," while downgrades and sign-ups to basic only have been sharply reduced.



### Marketing does pay

TKR Cable's central New Jersey system also has added customers at the same time it was raising basic rates, and the system is a good example of how effective marketing and good community relations can pay off. According to spokesman Patricia Dinsmore, the system now has 105,000 basic subscribers, up from 97,200 at this time last year. In May, TKR raised the basic price $1, to $12.95, announcing at the time that two more services (The Travel Channel and The Discovery Channel) would be added in July. The system also had scheduled a similar-

*See* **Package**, *page 42*

# Do high prices for systems mean rates must rise?

*Some think so, and worry about marketplace reaction*

**By Virginia Munger Kahn**

With cable systems trading at escalating prices, industry executives and regulators are expressing concern that those steep pricetags will impose upward pressures on rates for pay and basic services. That has serious implications for cable's goals of increasing penetration and avoiding reregulation of the industry by either federal or local authorities.

"I've seen projections by brokerage firms (that show basic rates) past the $20 mark in five years," says Bob Lewis, a long-time industry player and now vice president for corporate development at Tele-Communications Inc. "I think that's on the high side. We believe that when you reach $15 or $16 for basic, (increases) beyond that should be inflationary only."

TCI has been notable for its lack of acquisition activity on the system level in recent months. The same can be said for many of the top 10 MSOs, and some industry observers postulate that perhaps those companies know something the entrepreneurs and middle-level companies that are making the deals these days don't know.

"I'm making bids,"says Lewis, "but they're not successful. My fear is that (these high-priced systems) may have to increase rates to the point where they become unreasonable" in the future, he says.

It is a sentiment reflected by at least a few regulators. William Finneran, chairman of the New York State Commission on Cable Television, says the high prices in the marketplace now and the proportion of the acquisition cost that is being financed with debt "can only be effected in higher rates." Concerned that service and maintenance will suffer as profit margins are squeezed, the commission is thinking of developing a formula to assess a system's ability to meet the technological needs of the future and the needs

*See* **Prices**, *page 43*

**Price**, *from page 39*

of the community, taking into consideration the requirements for debt down the road.

Most industry observers say the problem is particularly acute in classic cable systems where the ability to increase penetration and add services may be limited. "The more classic properties will depend more on rate increases for revenue growth in the future than newer systems where there is a wider potential for growth," notes Jay Bush, senior vice president at Daniels Investment Services.

Industry executives point to a number of recent transactions as prime examples of what they consider 'excessive' prices with little upside potential other than in rate increases, including the Rockford, Ill., deal, the Horowitz properties transaction, and the Mountain Cable acquisition. On that last deal specifically, where 59,000 subscribers went to Adelphia Cable for $117 million, one operator said, "we couldn't come near those prices. The company has already rebuilt and remarketed the system and raised rates." Continuing to increase rates will be the new operator's only option, said this executive.

The same type of statement was made about the Horowitz properties, which also went to Adelphia. "I felt the price was way out of line," says one operator. "There's not that much growth potential there."

'There is no trend of new owners increasing rates above original owners. It's been a pretty balanced approach.'

—Susan Herman
LA Dept. of Telecommunications

## Gold mine for the taking

However, what is one operator's "tapped-out" system is another's goldmine just waiting to be exploited. The Mountain Cable deal was viewed by at least one other industry executive as having plenty of upside potential, especially with tier meltdowns and future growth in Burlington, Vt.

The same is true for the Rockford transaction. Last spring that deal was the subject of intense industry discussion about runaway system prices when it was announced that Adams-Russell would pay more than $90 million for the 50,000-subscriber classic system. Since that time Cablevision Systems has agreed to acquire Adams-Russell itself for what many observers consider a "full" price.

Yet, according to Neil McHugh, president and chief operating officer of Adams-Russell, the company predicted rates would increase about $1 the first year of the acquisition, $1.50 the second year, and between $1 and $1.50 over the next three years. The company wanted to be able to move up cash flows substantially in the short to medium-term "without having to just bang the rates," says McHugh. The deal worked not only at the $90 million price tag, he says, but also at the more recent $104 million price.

'In the deals we've looked at, operators are looking to raise basic rates from $11 to $15 over four or five years. That's a reasonable range.'

—John Waller
President, Waller Capital

While rate increases of $1 to $1.50 a year represent price hikes of between 6 and 10 percent, well in excess of inflation, most industry executives consider such dollar increases reasonable and, according to McHugh, the basic rate will still be below $20 in five years. The Rockford basic rate now is $12.15 per month and the system generates $18 a month in revenues per subscriber.

Where Adams-Russell figured it could make substantial gains in contributions to cash flow was in increasing pay penetration and cutting costs. HBO, for example, was penetrated at just 27 percent, while overall pay units represented just 42 percent penetration. Moreover, the system was operating at 39 percent margins, which Adams-Russell figured it could improve to 45 percent to 50 percent fairly quickly. The result would be a doubling in cash flow from $4 million a year to $8 million within just two years, said McHugh.

## Penetration on the rise

In fact, many operators are counting on improving margins and increasing overall penetration to help carry the debt burden taken on in these expensive acquisitions. Most operators are calculating that basic rates will rise to the mid- to upper-teens over the next two years and that penetration also will increase 1 or 2 percentage points per year.

The validity and importance of maintaining such growth rates is underscored in a recent report written by Bear Stearns media analyst Mary Kukowski. In that report, Kukowski concludes that over the next 10 years operators can expect to earn comfortably 15 percent returns on their investments in new acquisitions even though they are paying 12 times 1988 projected cash flows.

In her analysis, Kukowski assumes that revenues will increase 8 percent per year and that unit growth will equal only 1 percent or 2 percent per year. That revenue growth figure is a combination of price increases only in line with inflation of 5 percent per year and the growth in the number of subscribers. "I would be surprised if operators passed on those (system) prices to subscribers," says Kukowski, when they will be able to depend on margin increases and increases in services to cushion any increase in

*See* **Price**, *page 44*

'I'm making bids ... but they're not successful. My fear is that (these high-priced systems) may have to increase rates to the point where they become unreasonable in the future.'

—Bob Lewis
Vice President, TCI

**Prices**, *from page 43*

rates and meet the requirements for debt service.

That type of flexibility and the difficulty in pinpointing rate increases as tied specifically to high system prices already is evident. Operators have been extremely successful in cushioning rate increases by eliminating tiers and adding new services. Moreover, during the past six months, rate increases have been couched in terms of deregulation and the attempt to reach "market level prices" for cable services, particularly basic.

### Mixed record

Looking back on acquisitions that were considered expensive at the time of their consummation shows a mixed record on rate increases. At one end of the spectrum, the Chapel Hill, N.C., acquisition by Prime Cable for $1,900 per subscriber in August 1986 bolsters the argument that high prices result in high rates. While the system has not raised rates since May 1986, according to one city official, the most widely bought basic service of 29 channels costs $17.50 per month, substantially above industry averages of $11 to $13 per month. A 17-channel basic service costs $13.30 and the lowest tier of 12 channels costs $11.25. Those rates were put into effect by the seller as a part of the acquisition agreement.

In the future, according to John Waller, president of Waller Capital Corp., which brokered the deal, Prime will not be able to depend on rate increases to bolster cash flows. "The upside is in the growth" of the city itself, says Waller.

At the other end of the spectrum, last spring American Cablesystems paid $1,723 and almost $1,900 a subscriber for two systems in the Los Angeles market—the Communicom and Culver City properties—but the company has not raised rates more than any other new or existing operator in the market, according to Susan Herman, general manager of the Los Angeles Department of Telecommunications. "There is no trend of new owners increasing rates above original owners. It's been a pretty balanced approach," she says. In general, operators have increased rates about $1 so that most subscribers are paying between $12 and $13 a month for basic service. As Herman notes, penetration rates are notoriously low in the L.A. market, suggesting there is substantial upside revenue growth just in increasing the number of subscribers.

'We haven't begun to see the rate increases that will be needed to pay for these systems.'

—Edward Kearse
N.Y. State Cable Commission

In Tampa, Fla., where Jones Intercable acquired the former Tribune Cable system at a price estimated at $1,416 per subscriber in the spring of 1986, local regulators report that while rates have increased substantially over the past year—33.5 percent—Tribune's rates had been frozen since the company started construction in 1983. The result is that spread over the four years, rate increases in general have averaged about 5 percent, said Bob Sepe, director of cable communications for Tampa.

### Stiff price

Heritage Communications similarly paid a stiff price to acquire the Dallas cable system from Warner-Amex in November 1985—$1,325 per subscriber, yet according to Randy Morgan, compliance investigator for the city, there has been "little affect on rates overall" since the acquisition. Under Warner, basic rates were $12.95. This past spring Heritage raised basic rates 15 percent to $14.95, but pay rates declined $1 or 8 percent to $11.

Moreover, while Heritage instituted a $3.95 charge for remotes once it switched out the old Qube system and put in place a scrambled signal system requiring a Tocom converter, it stopped charging subscribers double and triple for the additional services they received on additional sets. Now there is only a $7 flat fee for additional sets. Moreover, subscribers that receive two or more pays receive a free remote.

Waller contends that operators simply are willing to take smaller rates of return in order to complete the deals they're targeting these days. "They're willing to take a 15 or 20 percent return rather than a 25 to 30 percent return," he says. "In the deals we've looked at, operators are looking to raise basic rates from $11 to $15 over four or five years. That's a reasonable range," says Waller.

Despite such assurances, Edward Kearse, executive director at the New York State Cable Commission, says he cannot see how the revenues that are predicted for these systems and the prices being paid for them work out. Not only do he and Finneran express their concerns about what a rise in interest rates could do to the economics behind these acquisitions, but also what the re-emergence of regulation of the cable industry could do to the fundamentals behind the system market.

The results could throw a real "monkey wrench" into the business, they say. "We haven't begun to see the rate increases that will be needed to pay for these systems," Kearse predicts. ■

tions, was part of the logic behind its recent $20 million unwired deal with Procter & Gamble (BROADCASTING, Oct. 26).

Bill Breda, senior vice president and general sales manager at Blair Television said that the Blair stations accepted the unwired network concept with Bristol-Meyers because it would bring in fresh dollars to national spot and also because the "rates were good." The Bristol deal with Blair also involves an examination of the top 25 markets for the placement of advertising in medical/health programing. Bristol has set aside a fund to support programing of community interest in local markets.

## Cable pricing—one year later

**Many are sticking to pattern begun last year of increasing prices for basic services and lowering pay fees**

Nearly a year ago, the cable industry was freed from rate regulation, and operators proceeded to raise basic rates while keeping pay rates flat or reducing them. Although operators were unsure what the net effect would be, it turned out to be a win-win situation. A survey by the National Cable Television Association (BROADCASTING, Nov. 30), database statistics compiled by the Cable Television Administration & Marketing Society (BROADCASTING, Aug. 24) and individual reports from cable companies show that basic and pay penetration increased in 1987.

As cable operators look to 1988, it appears they are following patterns established earlier this year. A random survey of multiple system operators and individual systems finds many will be raising basic rates on Jan. 1, while at the same time reducing or keeping pay figures unchanged. In some markets, the price of basic is nearly double the charge for a pay service, indicating the widening disparity between the two services.

Comcast Cable raised basic rates between $2 and $3 in 1987, while keeping pay rates the same or dropping them $1, said President Robert Clasen. The company plans to raise basic rates between $1.50 and $2 and "be much more aggressive in pay discounting" in 1988, said Clasen. For instance, in Comcast's new build in Philadelphia, Disney is being sold at $7.50 and HBO at $6.95.

Clasen said the company added about 100,000 basic subscribers in 1987, 30,000 coming from Philadelphia and the rest from internal growth. He said pay grew in direct proportion to basic in Comcast's owned and managed systems.

By the end of 1988, Clasen said, most Comcast subscribers will be paying $13.50 to $14 for basic, with most of the rate restructuring taking place in the first quarter.

An example, its Paducah, Ky., system raised basic rates from $9.95 to $12 on Jan. 1, 1987. Pay prices in the system stayed flat, averaging $10.10, and showed no growth throughout the year. Basic subscribers increased slightly, 400 being added to the 18,500-subscriber base, but Clasen said the system already has a basic penetration of 67%. Comcast will be dropping the average price of pay services $1 and Disney $2 in an attempt to increase the system's 9,000 pay subscribers.

Cablevision Industries will raise the price of basic early in 1988, but the increases will be smaller than in 1987. Michael Egan, vice president, programing, said Cablevision raised basic rates between $1.50 and $2 in 1987, while dropping pay rates $1. The average basic price ran about $13, while pays averaged about $8.50, Egan said. Because the company acquired a number of systems in 1987, Egan said it was difficult to quantify basic's growth, although he said "we gained in penetration." Pay remained flat, he said, although that was an improvement over 1986.

Egan said Cablevision will institute a basic rate increase of between 50 cents and $1 in the first quarter of 1988. Any remaining tiers in the company will be collapsed, said Egan, and those subscribers will see a $1 increase. Pays will remain the same, except for Disney, which Egan said will be dropped $3, from $11.95 to $8.95. Egan estimated 35% of Cablevision's systems won't have any increase at all.

Times Mirror saw healthy growth in both basic and pay penetration throughout 1987, said Larry Higby, senior vice president of marketing, while it raised basic rates an average of 10% and dropped pay rates slightly. For 1987, Higby said, Times Mirror added 70,000 basic subscribers and 92,000 pay units, the latter a 16% increase, all through internal growth. "We've been marketing like there's no tomorrow," Higby said.

The company will roll out a "modest" 8% increase in basic throughout the year, said Higby, and will keep pay prices flat. The pay unit growth in 1987, said Higby, was a signal to Times Mirror not to alter a successful formula. But he doesn't see 8% basic increases as necessarily automatic in the next few years. "Depending on inflation, the amount of the increases will go down," he said.

TeleCable which serves over 500,000, plans no rate increases in 1988, said Dan Dasnight, director of marketing. "We think we're high enough," he said, "and we don't want to be going back every year for a rate increase." TeleCable continues to use a tier structure, charging $11 for a 23-channel basic services and $18 for expanded 35-channel basic, which includes the more prominent cable-delivered services such as ESPN, CNN and USA Network. The company phased in a $1 rate increase for both basic and pay throughout 1987. The average pay price is $9, said Dasnight, factoring in package discounts. The a la carte pay prices are $11. Dasnight said pay was flat and basic rose slightly—.5% in 1987—although that small increase can be attributed to the overall high penetration the company has achieved, 62%, with the lowest tier and in the mid to high 50's with the expanded tier.

Dasnight said the company chose not to raise rates in 1988 because "we didn't want to get past the pain threshold. We're pretty happy with our pricing where it is," he said.

He said the company has been looking at melting down its two tiers, but said that is a difficult decision. He said the company is content with its present penetration figures, and merging the two tiers would require a substantial capital upgrade because half of its subscribers would need addressable converters. But as local ad sales pick up, providing another stable revenue stream, a tier meltdown may be a possibility, he said.

In Atlanta, Prime Cable plans to raise its basic rates $2.10 on Jan. 1, while dropping its pay $1.55. Allan Barnes, vice president and general manager of the system, said basic rates will rise from $14.85 to $16.95 for 45 channels, while pay rates will drop from $10.50 to $8.95 for the first service. The overall rate increase for most subscribers, Barnes said, will be 6%. Prime operates two franchises in the area and serves 147,000 subscribers. One franchise sold basic for $13.20 in 1986, the other $14.85. Prime standardized those rates to $14.85 for both on Jan. 1, 1987, while keeping the pay rates at $10.50. Basic penetration increased 2% in 1987, Barnes said, while pay penetration remained flat, althought the unit numbers increased because overall penetration widened.

During the year Prime added the Discovery Channel, C-SPAN, Viewer's Choice and a local shopping channel to its lineup, and it plans to add another PPV channel next year. The system plans to abandon its package discounts and sell all its pays on an a la carte basis for $8.95. Barnes hopes that downward rate adjustments will increase pay penetration.

In Salem, Ore., Viacom folded in two basic tiers in April and instituted a rate increase from $11.95 to $13.45 in August. According to Bert Rios, the Salem general manager, the system tries "not to tie rate increases to any other business decisions." There will be no rate hike in January, but a $1 increase in basic is in the budget, said Rios, for August 1988. "Costs go up each year," he said, and the company "tries to maintain regularity" in its pricing.

On Jan. 1, 1987, the company's 22 basic channels sold for $11.95, with a three-channel extra tier of Arts & Entertainment, Weather Channel and the Nashville Network selling for $3.95. The company folded that tier into the $11.95 tier in April, and continued charging $11.95 until the August increase. At the same time, the company dropped its second-set hookup fee from $3.50 to $3. In October, the system put A&E, Nickelodeon and C-SPAN on their own channels, and added two access channels and the Discovery Channel.

The system added 2,500 basic subscribers in 1987, the best year in three, said Rios. The area has been slow to recover economically since the recession of the early 1980's, he said.

Pay rates remained the same throughout 1987 (Playboy, $9.95; Showtime/Disney, $10.95; Movie Channel, $11.95, and HBO, $12.95), and 1,624 units were added throughout the year. Rios said pay rates will remain the same in 1988, but his margins will grow smaller as costs levied by the programers rise.

Steve Fry, the general manager of Warner Cable's Akron, Ohio, system, said basic rates will rise $1 to $15.95 for its 38-channel system while pay rates will stay the same in 1988. The system raised basic rates from $12.95 to $14.95 last Jan. 1, while dropping its pay rates from $12.95 to $11.95. Fry said basic penetration increased 4% in 1987, and although pay penetration remained flat, the number of units sold increased slightly because of packaging.

The first quarter of the year has been the strongest for pay and basic increases, said Fry, despite the negative effect of Christmas VCR sales on pay channels. Fry said the system is adding Viewer's Choice and a barker channel to promote the pay-per-view service.

In Manhattan, the two cable systems owned partially or outright by American Television & Communications are increasing basic rates $1 while dropping some pay rates. ATC's Manhattan Cable system (35 channels, 45 programers) will charge $14.95 for its basic service on Jan. 1, which duplicates a $1 increase that went into effect on Jan. 1, 1987. The system is also charging, for the first time, 50 cents for second-set hookups. The prices of the pay services—HBO and Cinemax, $12.95 and Sportschannel, $13.95—will remain the same. The company recently settled out of court an antitrust suit that had been brought by a citizen committee, which requested a non-Time Inc.-owned pay service be made available. The company plans to comply by adding one within the next months and others as the system's five-year, 70-channel rebuild is completed.

In northern Manhattan, Paragon Cable, jointly owned by ATC and Houston Industries, basic rates reflect those of Manhattan Cable. Paragon plans to drop its rate for HBO from $13.95 to $12.95, in line with its charges for Showtime.

Robert Benya, vice president, marketing and sales, said the system went full-time with ESPN, WTBS(TV) Atlanta and BET in 1987, and plans to add USA Network, Discovery and Arts & Entertainment (full time) in 1988. The Travel Channel will be added overnight and the Cable Value Network has been reduced from 24 hours to eight hours to make room for the changes. Paragon is gradually upgrading the system from 28 to 54 to 72 channels that will use fiber optics.

The new norms in the industry's service pricing are also reflected in smaller independent operators.

In United's Grand Junction, Colo., system, general manager Tom Worster said the system adjusted basic and reduced pay pricing on April 1, which resulted in an increase in basic penetration and decrease in pay units. The company added two services to its 12-channel basic tier, and increased the price from $11 to $11.95. Penetration for that tier increased from 17,600 to 18,949. The 10-channel expanded basic tier, to which four cable services were added in April, was reduced from $2.75 to $1.80. Its subscriber count jumped from 9,642 to 11,913. Pay pricing was adjusted to $11.95 for the first pay, $7.95 for the second and $5.95 for those thereafter. Pay units dropped 140 in 1987, said Worster, as the area continued to experience slow economic growth. Worster said the company is examining whether to melt down tiers, but has not decided what basic rate adjustments it will make in 1988. Pay pricing, he said, will remain the same.

At Cable TV of Coral Springs (Fla.), manager Tom Horne said his system will raise basic rates 50 cents in April, to $13.50, while pay service pricing will remain the same in 1988. Last April, the system raised the price of its 30-channel basic from $12 to $13, and penetration increased from 62% to 65%. The company added A&E and the Home Shopping Network to coincide with the April rate increase. Although pay rates ($10 for HBO, $9 for the others) stayed flat in 1987, the system's pay-to-basic ratio dropped from 137% to 131%. Horne said: "The demand is lessening" for pay services (he sees the VCR as the chief culprit), but he is unsure whether he would follow the lead of other operators and drop the price. The 50/50 split between program supplier and operator, he said, is shifting in favor of the latter. That squeezes the margin on pay services even further, Horne said. □

## Bottom■Line

**Universal language.** Former public broadcasting executive at WNET(TV) Newark, N.J., Paul Sladkus has formed new company in New York to place foreign-language programs and advertisements on U.S. television. Foreign-language advertising commitments have already been gained from Anheuser-Busch, which will air Italian-language ads during Italian soccer coverage fed to U.S. cable systems, and from Columbia Pictures, which plans Chinese-language ads for its new release, "The Last Emperor."

□

**Latin sounds.** Spanish-language TV group, Telemundo, has been awarded exclusive, multi-year advertising contract worth at least $5.8 million from subsidiary of Brazil's largest network, Rede Globo Television and Radio.

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# NCTA Study Finds Cable Bills Rose 6.7 Percent in First Half of 1987

By Larry Jaffee

WASHINGTON—The average cable subscriber's bill rose 6.7 percent during the first half of 1987, according to a survey conducted by the National Cable Television Association.

Basic cable rates during the period, the first under the rate-deregulation provisions of the 1984 Cable Act, jumped 10.6 percent, the survey found, but prices for pay networks and ancillary services declined.

But deregulation has also resulted in a 2.5 percent decrease in premium-network prices, increases in the number of channels offered on basic service and consolidation in the number of basic service tiers offered to subscribers, the study found.

The random-sample mail survey, conducted by the independent public accounting firm Arthur Andersen & Co., included responses from 590 cable systems representing 8 percent of all cable systems and serving 16 percent of the nation's cable households. The survey compared rates from December 1986 with those of June 1987.

The results of the NCTA survey were consistent with the findings of a survey of 282 operators conducted by *Multichannel News* and the Cable Television Administration & Marketing Society last year (see *Multichannel News*, Dec. 1, 1986, page 11. That survey found that operators were planning to increase rates during 1987 by an average of about 11 percent, with many of them also planning to expand service and reduce prices for pay networks and ancillary services.

According to Cynthia Brumfield, NCTA vice president of research and policy analysis, the survey was commissioned because there has been a lack of nationwide data on the effects of deregulation, which took effect Dec. 29, 1986.

NCTA was surprised by the resurgence in pay subscriptions, Ms. Brumfield said at a news conference here last week.

Of the 2,577 survey forms sent out to randomly chosen systems culled from A.C. Nielsen's Cable On-Line Data Exchange, 23 percent were returned, a high return rate considering the complexity of the survey, Ms. Brumfield said, adding that the survey took about 2½ hours to complete. The sample represented 33 percent of all systems nationwide.

Ms. Brumfield said NCTA does not plan to use this data to combat forces in Congress seek-

*See Rates, page 140*

## *Margaret Durborow New CTAM President*

WASHINGTON—The Cable Television Administration & Marketing Society Inc. has selected as its new president Margaret Durborow, vice president of marketing and programming of United Cable Television of Los Angeles Inc., industry sources said last week.

Ms. Durborow replaces Victor Parra, who resigned as executive director on Aug. 31 to pursue other opportunities in the association management and cable television fields.

According to United/LA president Bill Cullen, she will assume her new responsibilities at CTAM at about the second week of January. "Our loss is the industry's gain. In my opinion, she was absolutely the best qualified person," he said.

Ms. Durborow, who joined United in March 1985, was on vacation in Hawaii and unavailable for comment.

At United, she was responsible for all of the system's marketing and programming. In addition, she was very instrumental in developing the Southern California Cable Marketing Council, which achieved a common channel lineup for the area's 88 cable systems, Mr. Cullen said.

Ms. Durborow, who worked at CommuniCom (now American Cable in Los Angeles) before coming to United, also chaired a committee that established an advertising interconnect for Los Angeles, he added. ☐

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# Rates

*Continued from page 3*

ing to reinstate rate regulation, by showing that basic rates have not increased astronomically. Systems usually make rate changes in January of the year, she noted.

She added that NCTA does not have plans to do another survey.

The characteristics of the respondents indicate the sample contained a higher proportion of larger systems, NCTA said. Survey respondents have an average 12,180 subscribers in their systems, while the national average is 5,628 subscribers, according to Paul Kagan Associates Inc.

Other than system size, the sample is representative of cable systems nationwide, NCTA said.

The survey found that the total number of premium unit subscriptions increased for all but one service—The Movie Channel—and total number of premium units for the sample systems as a whole grew by 3.7 percent. In addition, total monthly revenues per subscriber, reflecting all revenues from subscriber services, grew by 6.7 percent from $21.59 to $23.04.

According to NCTA, the penetration of subscribers to homes passed by cable has not changed since deregulation. "Moreover the survey results indicate that the rates of both basic and premium service disconnections, which can be considered measures of customer satisfaction with cable, have declined since deregulation went into effect," the report stated.

Average revenue (including hookups but excluding advertising) per basic subscriber increased from $12.17 in December 1986 to $13.53 in June 1987, while average premium revenue decreased $7.88 to $7.70 during the same period.

The number of basic service channels received by the average subscriber increased by approximately two channels, or 5.9 percent, from 27.3 channels to 28.9 channels.

The number of cable systems offering two or more tiers of basic service dropped from 180 in December 1986, or 30.1 percent of the sample, to 151 in June 1987, or 25.3 percent of the sample, the study found.

Bob Scott, an AAC managing partner, said his firm did not figure out out the percentage or number of cable system respondents that experienced basic rate increases of more than 20 percent because the purpose of the survey was to determine a profile of the average subscriber. "The data's there, but hasn't been summarized," nor are there plans to do so, he said.

A Connecticut Cable Television Association study earlier this year on the effects of deregulation on all 26 cable systems in the state found that basic rates went up 14.6 percent, while premium rates decreased 14 percent. Revenue per subscriber rose 7.3 percent—from $23.42, average out all of 1986, to $25.13 for the first seven months of 1987.

Cynthia Pols, National League of Cities counsel, criticized the 23 percent response rate for the NCTA study, and said a recent NLC study that showed rate increases of 27 percent was more likely to reflect the result of deregulation.

In the NLC study, 450 (52 percent) of its members were asked a wide variety of questions, including some on cable regulation. "If you're in the cable industry and raised your rates 60 percent, you're probably not going to respond to a survey," she said.

NCTA spokesperson Lynn McReynolds said comparing the NLC and NCTA surveys is "like comparing apples with oranges."

John Mansell, senior analyst with Paul Kagan Associates Inc., said he conducted an unscientific survey looking at the effects of rate deregulation.

"Over 900 systems had increases in the first half of 1987 that averaged 24.5 percent," he said, conceding that certainly there were other systems that raised rates and were not included in the survey.

Ms. Pols said that because the Kagan and NLC surveys' results were close it was more likely that they were more accurate. ☐

# Op-Owned PPV Network Set To Launch

NEW YORK—Home Premiere Television, the operator-owned pay-per-view consortium, will launch in December with films from Columbia Pictures, Tri-Star Pictures and at least six other distributors, but Warner Bros. Inc., Universal Pictures and Paramount Pictures Corp. still have declined to make deals with the fledgling PPV operation, according to information released by Home Premiere last week.

Vice president of programming Jim English expressed optimism that HPTV will eventually make a deal with at least two of the holdouts.

"Why would they cut out a third of their market?" Mr. English said. HPTV has commitments from its multiple systems operator owners for at least 2.3 million subscribers. HPTV is a joint venture of American Television & Communications Corp., Continental Cablevision, Cox Cable Communications, Newhouse Broadcasting and Telecable Corp.

HPTV will program 22 hours a day, about 11-15 titles per month. ☐

# Stereo Television Makes Little Difference, Advertisers Say

By Jeannine Aversa

WASHINGTON—High-tech soothsayers three years ago pointed to the emerging technology of stereo television and wrung their hands in happy anticipation. Advertisers will jump to have their messages broadcast in stereo, broadcasters will feed off this advertising frenzy and everyone from set manufacturers to program and commercial producers will want to tap the concept, they said.

**Special Report on Stereo Television**

But what was touted as the biggest change to commercial television since color has yet to meet those expectations, said broadcasters and advertising experts, although they are not sure why.

While more than 400 TV stations broadcast in stereo, perhaps only a handful, if that many, broadcast commercials in stereo, estimate engineers and television production people. One leading explanation for this is there's not an abundance of commercials produced in stereo, they said. But the decision to go stereo vs. mono in a commercial message is left in the hands of advertisers or their agencies.

Rod Abernathy, a producer, writer and arranger at Videofonics Inc. in Raleigh, NC, said many advertisers and many of his clients don't think about having a stereophonic commercial until it's pointed out to them. "I'll ask them if they want stereo or mono, and they won't know," he said. "But I'll sit them down and play it and they'll say, 'Oh, yes, stereo.'"

Mr. Abernathy has written and arranged national radio spots for McDonald's Corp. and has composed, arranged and recorded 10 TV spots for Honda Motor Co. Videofonics is a production house and a recording studio.

"A lot of clients are not thinking about (stereo), and that's a shame," said Mr. Abernathy, who said that from a creative viewpoint, he'd prefer to have his spots broadcast in stereo. "I'd like to push stereo; it's 10 years overdue," he said.

The Television Bureau of Advertising, the Association of National Advertisers and other ad groups are not sure why advertisers are not latching on to stereophonic commercials.

TvB and ANA said they have not conducted research on stereo television and did not know how many commercials nationally have been broadcast in stereo.

Dean Christon, marketing specialist at Levi Strauss & Co. in San Francisco, said music is a "very important" theme in most Levi advertising campaigns, particularly, the "501 Blues" television spots for its jeans. He said having spots run in stereo is a "nice thing to have," but added that stereo television does not figure into Levi's media buying formula.

"Will it make or break our decision to buy advertising spots? Not really. It's not a buying decision," Mr. Christon said.

Echoing comments of advertising agencies, Mr. Christon said it would be just as difficult for advertisers to keep track of commercials broadcast in stereo. "They're not noted in our media reports," he said.

Other big television advertisers agree that stereophonic commercials sound great, but don't influence advertisers to buy time on stations that have the capability to broadcast in stereo vs. stations that don't.

H.J. Heinz Co., for example, just launched a new advertising campaign for its ketchup, where music is a key part of the company's pitch. The spots are running prime time on TV stations across the country and feature a newly released rock tune, *Jane's Getting Serious*.

Harry Carroll, a spokesman for Heinz U.S.A., a division of H.J. Heinz, said the new commercials are not running in stereo and that Heinz, like other advertisers, is concerned about the commercial's reach. "We don't at all consider whether a station can broadcast in stereo when placing an advertisement. We really do not consider that an issue," Mr. Carroll said.

Most broadcasters said that if advertisers considered stereo an issue they would not have to pay more to have their messages broadcast in stereo or have to pay more for ad time that is next to a program broadcast in stereo vs. a program without stereo sound.

KIRO-TV, the CBS affiliate in Seattle, was one of the first TV stations in the country to go stereo three years ago. Officials said stereo hasn't increased the station's advertising sales.

"I can assure you no one (advertiser) is asking us if we have the ability to broadcast in stereo. At this point in time, it is not a buying criteria at all," said Michael Poth, vice president and director of sales for KIRO.

Mr. Poth said stereo television has to build its penetration before it can become a component in ad buys. That means more people need to either hook their sets up to stereo receivers or buy stereo TVs. ☐

# Orbis Sets Expansion With $30 Million Fund

By Andrew Grossman

NEW YORK—Orbis Communications Inc. last week signaled its intention to become a major player on two fronts—first-run syndication and made-for-television movies—using an infusion of $30 million from its new parent company, Carolco Pictures Inc.

Orbis signed an agreement with Roger Gimbel and Ken Locker to produce movies, miniseries and eventually series for broadcast network television under the banner of Carolco/Gimbel Productions with Mr. Gimbel serving of president of the new company and Mr. Locker as executive vice-president.

In its syndication division, Orbis said it will market two new shows for the fall of 1988: *Love Court*, a strip comedy court show targeted for late afternoon; and *Public People/Private Lives*, a weekly magazine/entertainment barter show hosted by Sarah (*Real People*) Purcell.

*Love Court* is described as a hybrid of *People's Court*, *The Newlywed Game* and *Love Connection* where couples with romantic problems will appear before a judge. They will be questioned by a panel of comedians and celebrities who will help settle the conflicts. Jenifer Lewis, an actress, is cast as the judge. The cash/barter show returns one minute to Orbis.

The show, which Orbis President Bob Turner described as "a unique blend of reality and comedy," is the second comedy court show to be introduced recently; Blair Entertainment is developing *Celebrity Courtroom*.

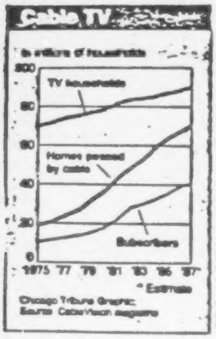
*Public People/Private Lives* will center on the personal lives of celebrities who will be interviewed and filmed in America and abroad. Orbis will pitch the show for either weekends, or prime time on weekdays which affiliates can use to pre-empt the network, Mr. Turner said.

Pilots have been shot for both programs, and Orbis will begin this week peddling the shows to stations.

Business

Newswatch D2
NASDAQ D3

Gannett Westchester Newspapers/Friday, March 6, 1987



* Estimate

Chicago Tribune Graphic
Source: CableVision magazine

# Cable rate hikes spreading

By Brian Tumulty
Staff Writer

Most of the 167,000 Westchester-Putnam area households that subscribe to cable television will have one new thing in common by April 1 — they'll be paying more than they did last December.

Six of the seven cable television companies which service the two counties have either increased their monthly charge for basic service since Jan. 1, or will do so at the end of this month.

Group W, with 7,780 customers in Mount Vernon, has so far kept its basic monthly rate at $11.50. The only thing it has changed is its name, becoming Paragon Cable this month to reflect new ownership.

Locally, the six companies in Westchester-Putnam which have announced rate increases have changed their rates by roughly $3.15 a month, from a previous composite rate of $9.87 to $12.25.

There are wide ranges, however, in the rate increases, sometimes even among subscribers of the same company. The largest price increases are for subscribers who were previously paying about $8 or $9 monthly for basic and who now will pay around $12 to $14.

However, almost all subscribers in the area will be paying a new basic rate within the range of $11.45 to $12.95.

The exceptions: subscribers in Port Chester and Harrison who received a March 1 increase from $4.30 to $6.20, and any new subscribers to Cablevision in Yonkers. Cablevision is charging existing subscribers a new rate of $13.95 for basic service, but new customers must pay $19.50. The former rate in Yonkers was $8.80.

UA Columbia Cablevision, the largest system in the area, increased its basic monthly rate from $10.75 to $13.50 effective Feb. 15 for all 60,000 customers in 30 communities of southern and central Westchester.

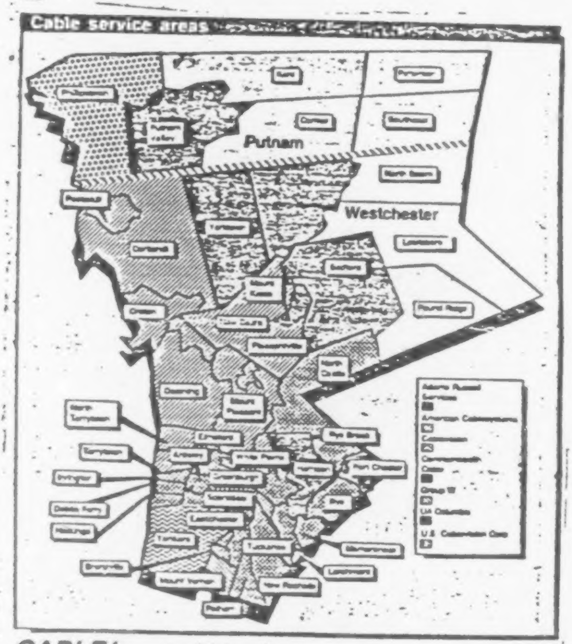
"I think it's a very reasonable price," said Ira Birnbaum, UA Columbia's system manager. "We have looked at our own cost and what people are charging for comparable services in the metropolitan area."

Deregulation of rates took effect in January at the direction of the Federal Communications Commission.

Previously, a local cable television franchise was required to seek approval from the local town board or city council in order to increase its fees for basic service. The rates charged for premium channels such as Home Box Office and Sportschannel have not been regulated for several years.

Under legislation passed by Congress in 1984, the FCC was given the

Please see CABLE on page D3



## CABLE/From page D1

discretion to decide when and how government control over basic monthly subscription rates would be removed.

Although a federal lawsuit has been filed challenging the manner in which the FCC took action, the lifting of controls has gone ahead.

In New York, most of the state's 104 cable television companies have instituted rate hikes since Jan. 1, according to Ann Dalton, a senior municipal consultant for the state Commission on Cable Television.

"No question it's been a surprise to some of the subscribers, but the increases in fact have been fairly modest," said Dalton.

The state agency has no estimate of what the average monthly increase has been, but Dalton said, "It can be as little as a dollar, and in a few places it's been as much as seven dollars."

She said that most often the larger increases have been accompanied by the addition of new channels to the basic package.

Bob Perry, a lawyer for the American Civil Liberties Union who is contesting the FCC's action in the U.S. Court of Appeals for the District of Columbia, said Thursday he is concerned that the rate increases will "snowball."

"I think you are seeing the momentum building," said Perry, estimating that the number of companies which have raised rates has grown sevenfold nationwide from a previous level of 60 a month.

The ACLU has been joined by the city of New York, the National League of Cities and several other parties in contending, in part, that the FCC did not conduct adequate research before it took action.

The following is a summary of the other local increases:

☐ Adams-Russell Co., from $4.30 to $6.20 for customers in Port Chester and Harrison effective March 1, from a previous range of $7.15 to $11.80 to a new uniform rate of $13 in five Westchester and two Putnam communities effective April 1.

☐ American Cablesystems, from an old rate of $10.45 to a January rate of $12.45 in three communities of central and northern, from $9.40 to $11.45 in others.

☐ Commonwealth Cable, from a previous range of $9.45 to $11.45 to a new rate of $12.95 for four Putnam towns.

☐ U.S. Cablevision increased the basic rate from a range of $8.34 to $12 in the unincorporated part of Philipstown and Nelsonville, and from $8.75 to $12 in Cold Spring.

Consumers with questions about their cable television service can telephone the state commission at 1-800-342-3330.

EXHIBIT P

# WEST VIRGINIA CABLE MATERIALS

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of

| | |
|---|---|
| Amendment of Parts 1, 63 and 76 of the Commission's Rules to Implement the Provisions of the Cable Communications Policy Act of 1984 | MM Docket No. 84-1296 |

## COMMENTS OF THE STATE OF WEST VIRGINIA

The State of West Virginia, by its attorneys, respectfully submits these comments in response to the *Further Notice of Proposed Rule Making*, FCC 87-307, released September 28, 1987 ("*Further Notice*") in the above-captioned proceeding initiated to consider revisions to the "signal availability standard" in the Commission's cable rate regulation rules. 47 C.F.R. § 76.33(a)(2).

Since January of 1987, cable television consumers in West Virginia have been experiencing a host of negative effects produced by the FCC rules promulgated under the Cable Communications Policy Act of 1984. 47 U.S.C. § 521 *et seq.* ("Cable Act"). Primary among these negative effects, from the consumer viewpoint, have been the exorbitant increases in rates imposed by cable operators in West Virginia who believed they fell under the Commission's definition of "subject to effective competition." These rate increases, for the most part, have not paralleled any new capital expenditures by the cable operators, nor have they been adequately explained through any other industry rationale.

Faced with a situation which was worsening almost daily, the State of West Virginia welcomed the decision by the United States Court of Appeals for the District of Columbia in the ACLU v. FCC case to remand to the Commission its definition of "signal availability." American Civil Liberties Union v. FCC, 823 F.2d 1554, 1571-73 (D.C. Cir. 1987). The ACLU decision has offered all parties concerned a chance to reexamine the original goals of the Cable Act and the rules promulgated to meet those goals. In this spirit of arriving at a more realistic regulatory structure for the cable television industry, the state of West Virginia welcomes the present opportunity to point out its particular critiques of the Commission's previous "signal availability" standard and its previous waiver procedure.

## I.

## INTRODUCTION

Section 623(b)(1) of the Cable Act of 1984 required the Commission to "prescribe and make effective regulations which authorize a franchising authority to regulate rates for the provision of basic cable service in circumstances which a cable system is not subject to effective competition." 47 U.S.C. § 543(b)(1).

In April 1985, the Commission adopted rules declaring that a cable system faced "effective competition" in providing basic cable service whenever three off-the-air broadcast signals were "available" in the cable community. Report and Order in MM Docket No. 84-1296, adopted April 11, 1985, 50 Fed. Reg. 18,637, 18,648-50 (1985) ("Report and Order"). Under the Commission's rules, a broadcast signal would be deemed "available" off-the-air in the cable community if: (1) the signal placed a predicted Grade B contour over any portion of the cable community; (2) the signal was "significantly viewed" in the community; or (3) the signal was a translator station licensed to serve the community and did not already carry a Grade B contour or significantly viewed signal. Id. at 18,650-51.

The D.C. Circuit upheld, in large measure, the Commission's rules, including its three-signal standard of "effective competition." ACLU, 823 F.2d at 1571-73 (D.C. Cir. 1987), Petition for cert. filed, sub nom. State of Connecticut v. FCC, ___ U.S.L.W. ___ (U.S. Oct. 15, 1987), No. 87-671.[1] While recognizing that "the measures of signal availability chosen by the Commission are highly imperfect," the court declined to hold that use of either measure was itself arbitrary and capricious. Id. at 1572. Because the court found certain aspects of the signal availability standard to be arbitrary and capricious, it remanded to the Commission the signal availability standard for further explanation or development of a new standard.

On remand, the Commission proposes to continue using the Grade B contour and "significantly viewed" status as measures of broadcast signal availability. Further Notice at ¶ 6. The Commission, however, proposes certain revision to each measure. Id. at ¶¶ 7-10. Finally, the Commission proposes several modifications to its waiver procedures designed to remove the substantial economic barriers that the current waiver system poses to franchising authorities. Id. at ¶¶ 12-16.[2]

## II.

## THE COMMISSION SHOULD ADOPT THE GRADE A CONTOUR AS THE ONLY MEASURE OF BROADCAST SIGNAL AVAILABILITY.

Although the court in ACLU v. FCC upheld the Commission's selection of the Grade B contour and "significantly viewed" standards as measures of broadcast signal availability, it hardly gave the Commission's selection of those measures a ringing endorsement. Indeed, as noted, it observed that those measures are "highly imperfect." 823 F.2d at 1572. West Virginia believes that an ample number of reasons exist for the Commission to replace both measures with another measure--the Grade A contour of a broadcast signal.

The Grade B contour of a broadcast signal is merely a predictive measure of signal strength. It simply defines a geographic area surrounding the broadcast station in which a specified field strength designed to yield a reasonably clear picture is predicted to be available to 50 percent of the households near the outer limit of the contour 90 percent of the time. 47 C.F.R. § 73.884(c).[3] Using this prediction, the probability that a randomly selected television household situated on the outer limit of a single Grade B contour of a certain broadcast signal, will receive a reasonably clear picture of that signal at any given time is only 45 percent.[4] The probability that such a televisi household will not receive a reasonably clear picture of t broadcast signal is, therefore, 55 percent.

The folly of relying on the Grade B contour is represented clearly when one considers the possible outcomes under a three-signal standard. If the probability is only 55 percent that a randomly selected television household near the outer limit of one Grade B contour will actually receive a reasonably clear picture 90 percent of the time, then the probability that a randomly selected television household near the outer limits of three Grade B contours will actually receive three reasonably clear pictures 90 percent of the time is only 12 percent.[5] In other words, the odds are eight-to-one against a randomly selected household receiving reasonably clear pictures from all three signals 90 percent of the time.[6]

If we remember that the original purpose of employing a signal contour standard was to establish a measure of "effective competition" for the cable industry and local regulatory bodies, then the use of the Grade B contour, with its incumbent low probabilities, appears especially ill-reasoned. After all, it is hard to conceive of the FCC seriously arguing that a cable operator who serves a community which lies on the outer reaches of three Grade B contours, where the odds of independently receiving reasonably clear pictures of three broadcast signals 90 percent of the time are eight to one, is somehow subject to competition from those three signals. A quick response might be that the community on the rim of only three Grade B contours is a hypothetical example and one not likely to be found in practice. An equally quick glance at the Grade B contour map of West Virginia will refute such a critique. Many of the smallest and most rural cities and townships of West Virginia, especially those in the eastern part of the state, lie in the outer sections of three or even fewer Grade B contours, including cities and townships in the counties of Hampshire, Mineral, Hardy, Grant, Pendleton, Tucker, Randolph, Pocahontas, Webster, Nicholas, Fayette, Raleigh, Wood, and Wyoming. Even some of the larger cities in West Virginia, such as Parkersburg, Oak Hill, and Beckley, fall in the outer limits of three or fewer Grade B contours.[7]

Given the realities of the Grade B contour probabilities--which apparently were not presented to the court in ACLU v. FCC--it can no longer be assumed that the Grade B contour "bears a reasonable relationship to actual signal availability." 823 F.2d at 1572. While the court in ACLU v. FCC noted that another panel had previously referred to the Grade B contour as indicating "satisfactory off-the-air viewing," id., citing Tele-Media Corp. v. FCC, 697 F.2d 402, 404 n.4 (D.C. Cir. 1982), that was merely a passing reference, constituting dicta in the opinion. The suitability of the Grade B contour as a measure of broadcast signal availability was never an issue in that case. Moreover, that panel's passing reference was contrary to a prior Commission pronouncement stating that the Grade B contour was not a reliable indication of actual signal availability. See, e.g., Protection of Coverage of TV Broadcast Stations, 22 FCC 2d 359, 358 (1970).

If we are going to have to live with the probability-based, signal contour standard as one of the measurements of "effective competition," then the Commission should at least utilize a signal contour which produces a much higher probability of actual reception by each television household. To this end, West Virginia suggests that the Commission replace its use of the Grade B contour with the use of the Grade A signal contour standard. The Grade A contour defines a geographic area surrounding a broadcast station in which a specified field strength designed to achieve a reasonably clear picture is predicted to be available to 70 percent of the households on the outer limit of the contour 90 percent of the time. 47 C.F.R. § 73.684(c). The probability that any given television household on the outer limit of the Grade A contour of three broadcast signals will receive a reasonably clear picture of all three signals 90 percent of the time is 34 percent.[8] The Grade A contour thus bears a much closer relationship to actual broadcast signal availability than does the Grade B contour, assuming that the odds against a randomly selected household receiving reasonably clear pictures from all three signals are at least reduced to three-to-one.[9]

The Commission should also discard the "significantly viewed" status as a measure of broadcast signal availability because, like the Grade B contour, it bears little relationship to the actual availability of a broadcast signal in a cable community. The Commission's "significantly viewed" standard was created 15 years ago for a purpose entirely unrelated to its use by the Commission here. Cable Television Report and Order, 36 FCC 2d 143, 174 (1972). Under the Commission's rules, whether a broadcast signal is "significantly viewed" depends upon its "share" and its "net weekly circulation," which are defined as follows:

> As used here the term net weekly circulation is a measure of the number of households that viewed a station for five minutes or more during an entire week, expressed as a percentage of the total television households in the community. Share of viewing hours is a measure of the total hours all television households in the community viewed a station during the week, expressed as a percentage of the total hours these households viewed all stations during the period surveyed.

Id. at 175. A network station is considered to be "significantly viewed" if it obtains a three percent share and a net weekly circulation of 25 percent; an independent station is considered to be "significantly viewed" if its share is two percent and its net weekly circulation is five percent. Id.; 47 C.F.R. § 76.54.

That a certain broadcast signal meets these minimum standards for "significantly viewed" status in a given cable community hardly provides reasonable assurance that the signal is actually available to television households in that community. A net weekly circulation of 25 percent, for example, strongly suggests that the broadcast signal is actually unavailable to the 75 percent of television households in that community which did not view the signal for even five minutes during the entire week. Similarly, that suggestion becomes even stronger if the net weekly circulation is only five percent. Yet the latter figure, coupled with a two percent viewing share, would qualify an independent station's broadcast signal for "significantly viewed" status.

Use of the "significantly viewed" standard to measure broadcast signal availability would also result in an anomaly because of the separate threshold figures for network and independent station signals. For example, an independent station signal having a two percent viewing share and an eight percent net weekly circulation would be deemed available, but a network station signal having three times as large a viewing share (six percent) and net weekly circulation (24 percent) would be deemed unavailable.

While the court in ACLU v. FCC declined to hold that the Commission's use of the "significantly viewed" standard was arbitrary and capricious, 823 F.2d at 1572, it did note certain "potential difficulties" in applying this standard. Id. at 1573 n.38. Although it only discussed the problems created because "significantly viewed" statistics are compiled on a county-by-county basis, id., this in no way suggests that it deemed all other aspects of the "significantly viewed" statistics to be free from "potential difficulties."

In sum, the Commission should discard both the Grade B contour and "significantly viewed" measures of broadcast signal availability. Simply stated, these loose and outdated estimations bear no legitimate relationship to the actual availability of broadcast signals within a cable community and, therefore, provide a wholly inaccurate reflection of the actual level of competition in each local broadcast reception market. Moreover, the Commission's continued use of the Grade B contour and the "significantly viewed" standards, combined with a waiver procedure requiring expensive engineering studies paid for by the franchisor municipalities, will in practice force a large number of communities in West Virginia, which have no other competitive options in their local broadcast signal market, to accept the establishment of FCC-sanctioned monopoly pricing as a cost of receiving cable television service. In lieu of these two signal measures, the Commission should at least consider replacing the Grade B contour with the Grade A contour as a measure of broadcast signal availability.

## III.

## THE COMMISSION MUST ADOPT A FLEXIBLE WAIVER PROCEDURE.

As the court in ACLU v. FCC observed, the Grade B contour does not take into consideration geographic terrain which may prevent reasonably clear reception in a television household:

> A "predicted Grade B contour" is a measurement of the anticipated strength of a broadcast signal. Use of the Grade B contour enables the FCC to predict the "approximate extent" to which a signal is viewable in the community covered by this contour. See 47 C.F.R. § 73.683(a) (1985). The predicted contour . . . is based on general engineering principles, and does not take into account site-specific factors that could affect the actual broadcast strength in a community. Thus, the predicted contour does not take into account the extent to which "terrain" or

> "interference" disturbs the ability of viewers to receive a clear picture. Id.

823 F.2d at 1560-61 n.8. This observation is particularly apt to broadcast signals and television households in West Virginia.

As the Commission may know, West Virginia is known as the "Mountain State" because of its rugged terrain. While the average elevation in West Virginia is 1,500 feet above sea level, there is a range of 4,863 feet between the highest and lowest points in the state. Most of the state, especially the eastern portion, consists of heavily forested mountain ridges separated by narrow valleys. Needless to say, many of the cable communities located in those valleys experience severe broadcast signal reception problems notwithstanding their coverage by the Grade B contours of various broadcast signals. Even West Virginia's largest urban center, its capitol city of Charleston, is surrounded by steep, 800-1000 ft. valley walls.

With an accurate knowledge of West Virginia's inhospitable topography in mind, it is very conceivable that many cities and towns located within the state will apply for waivers on the ground that three broadcast signals are not actually available off-the-air in their communities. Yet, because of the rural nature and small tax base of most of these cities and towns, and because West Virginia's economy, as a whole, has fared relatively poorly in recent years, most potential waiver candidate municipalities in the state will have little or no resources to expend on the expensive requirements of the waiver process as it is presently constituted. West Virginia, therefore, supports the Commission's decision to reform the waiver process, as it was urged to do by the court in ACLU v. FCC. Id. at 1573, nt.37. But at the same time, the state believes that the Commission's proposals fail to realize the full potential for reform of the waiver process in at least two respects.

### A. A Penetration Level of 65 Percent Should Trigger a Shift of Burden of Producing Field Strength Measurements to the Cable Operator.

Because high cable penetration rates are often thought to be a reliable bench mark of broadcast signal reception problems, the Commission proposes to shift the responsibility for obtaining signal strength measurements to the cable operator when cable penetration falls in the range of 80 to 85 percent. West Virginia concurs with the FCC's proposal to shift responsibility for the studies to cable operators when a certain threshold penetration level is reached, but the state also urges the Commission to set the level at a more reasonable 65 percent. In addition, we urge the Commission to create an irrebuttable presumption of off-the-air broadcast signal unavailability when the penetration level exceeds 90 percent.

Despite the Commission's reservations, cable penetration is generally a reliable indicator of off-the-air broadcast reception problems. Further Notice at § 15 n.18. The Commission's suggestion that a high penetration may instead reflect superior service or low rates is belied by recent experience in West Virginia and elsewhere. Id. A high penetration level surely cannot be attributable to low rates since cable penetration has remained unchanged in the face of a 10.6 percent average increase in the price of basic cable service during the first six months of 1987.[10] In Charleston, West Virginia, where the penetration rate is at 75 percent, the price of basic cable service shot up overnight by 67 percent in January of 1987. High penetration is likewise unattributable to cable operators' superior service since recent surveys have shown that cable subscribers generally do not give their cable operators high marks in customer relations.[11] Again, using Charleston as an example, despite an overnight 67 percent increase in price, the local operator has not made any new capital expenditures, nor implemented any improvements to customer service, nor offered any new programming to its cable subscribers. This pattern has been repeated again and again in many West Virginia communities where the penetration rate is in excess of 65 percent. Thus, it is clear, once having disproved the hypothesis of better service and lower rates, that cable penetration is at least a reliable warning of off-the-air broadcasting reception problems. Certainly cable penetration is no less speculative a measure than is the Grade B contour.

The Commission, however, proposes an unduly high threshold level of penetration in order to trigger the shift of responsibility for obtaining field strength measurements to the cable operator. The average nationwide penetration level, after all, is only 50 percent. This statistic suggests that in a typical television market, served by both cable and other reliable off-the-air signal sources, one out of every two consumers will choose the cable product. However, it does not follow that as the off-the-air signals become less and less reliable, depending on the community assessed, the cable penetration rises evenly to meet that unreliability. Rather, we can assume that if a consumer in a more isolated community is receiving off-the-air signals full of "noise," that consumer is either going to purchase cable or go without television altogether.

The analogy would be to concepts of "market power" in antitrust law, the ultimate point being that each percentage point of increase in a community's cable penetration rate above the 50 percent national average represents a geometric increase in the affinity of the consumer for the clear reception offered by cable. In other words, the graph comparing signal reception difficulties with cable penetration rates is not likely to be represented by a gentle slope. Instead, West Virginia would argue, after its own informal comparison of the state's penetration statistics to the signal contour and topographical maps of the state, that at a penetration level well below the Commission's suggested level of 80-85 percent the attendant problems with off-the-air signal availability in a community increase dramatically. This lower threshold appears, using an informal basis for conclusion, to be in the range of a 65 percent cable penetration rate.

Given the possibility that a more detailed and far-reaching study of the geometric progression, which West Virginia theorizes above, might prove the 80-85 percent figure an arbitrary boundary, and assuming the 80-85 percent figure was chosen by the Commission without reference to its own empirical data, the state requests that the FCC consider adopting the 65 percent limit and the 90 percent presumption or, in the alternative, conduct a study which compares cable penetration rates in individual communities to the difficulties with off-the-air signal reception experienced in those communities before adopting any percentage indicator.

### B. Cable Subscriber Surveys Should Suffice to Establish Off-The-Air Broadcast Reception Problems.

The Commission proposes several alternative methods for field strength measurements that are less expensive than traditional methods but nevertheless provide adequate information on the field strength coverage of broadcast signals. Further Notice at ¶ 14. Because of the highly technical issues posed by each of these methods, West Virginia reserves its comment in this area until it has had an opportunity to review the comments of other interested parties on these proposals.[12]

West Virginia, however, urges the Commission to consider one other alternative that would greatly simplify the burden on cities and towns seeking waivers while simultaneously providing the Commission with adequate information as to broadcast signal availability. Cities and towns should be permitted to justify waiver requests with cable subscriber surveys, conducted in their communities, which would present the opportunity to discover whether significant numbers of cable subscribers face broadcast reception problems. Such surveys would, of course, have to follow sound statistical sample principles, but assuming such principles are applied, there is no good reason why such cable subscriber surveys could not serve to justify waiver requests. In the past, individual television markets have been proven especially amenable to this type of specific survey. In fact, this amenability is borne out by the Commission's own use of th cable penetration rate, a figure often arrived at through the analysis of specific cable viewing data requested by t Arbitron and Neilson corporations on each of their househo surveys.

The goal set by Congress in the Cable Act was to assu market growth in the cable industry while maintaining consumer sovereignty over the forces in that market. With this goal in mind, it would be disingenuous for the Commission to continue its requirement that highly technical and expensive studies of field strength measurements be conduct to determine competition levels in each market. This requirement favors the inherent resources of the cable industry and individual cable operators when simpler, less expensive and equally valid consumer surveys could provide all the information necessary for a proper waiver determination.

## CONCLUSION

The Commission should discard its two current measures of signal availability--the Grade B contour and "significantly viewed" standards--because they bear only a remote relationship to the actual availability of broadcast signals in a cable community. In lieu of those two measures, the Commission should promulgate a more legitimate measure of broadcast signal availability--the Grade A contour of the broadcast signal. In addition, the Commission should implement a shift in the burden of obtaining field strength measurements of broadcast signals to the cable operator whenever cable penetration exceeds 65 percent in the cable community. As part of this shifting of the testing burden, the Commission should also permit a presumption of broadcast signal unavailability whenever cable penetration in a given cable service area exceeds 90 percent. Finally, the Commission should reconsider its current procedure for waiver of the signal availability measure of effective competition and consider instead permitting cities and towns to justify their waiver requests with cable subscribers surveys showing that significant numbers of cable subscribers face broadcast reception problems.

Respectfully submitted,

THE STATE OF WEST VIRGINIA

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## FOOTNOTES

[1] Although the court upheld the Commission's three-signal standard, it was not overly impressed by the empirical evidence supporting that standard and thus instructed the Commission to "carefully monitor the effects of its regulations and make adjustments where circumstances so require." ACLU v. FCC, 823 F.2d at 1565.

[2] West Virginia notes with dismay that the Commission does not propose to review its three-signal standard of "effective competition" in light of the empirical evidence that has now become available on the effects of rate deregulation. Since basic cable service rates were deregulated throughout most of the United States on December 29, 1986, the price of basic cable service has increased 10.8 percent on the average, according to a recent study by the National Cable Television Association ("NCTA"). "NCTA Study Finds Cable Bills Rose 6.7 Percent in First Half of 1987," Multichannel News, Nov. 30, 1987, at 3. Despite this significant price increase, the NCTA found that cable subscribership has remained unchanged thus suggesting little, if any cross-elasticity of demand between basic cable service and competitive alternatives. The NCTA survey further showed that the average number of channels included within basic cable service has slightly increased from 27.3 to 28.9 channels. Id. This latter finding, coupled with a recent Neilson survey that showed the nonbroadcast component of basic cable service commanded significant viewing shares in cable households casts substantial doubt on the Commission's hastily formed predictive judgment that three off-the-air broadcast signals provide effective competition for basic cable service. The Commission's failure to begin to re-examine the three-signal standard of "effective competition" in light of this recent empirical evidence is contrary to the court's remand instructions to the Commission to "carefully monitor the effects of its regulations and make

adjustments where circumstances so require." ACLU v. FCC, 823 F.2d at 1565.

[3] West Virginia purposely omits any discussion of the other 50 percent of the households who receive the same signal some unspecified amount less than 90 percent of the time. After all, it is hard enough already to swallow the use of the Grade B contour, which only provides a guarantee of reception 90 percent of the time, as a measure of competition for cable television, which provides a 100 percent guarantee of reception.

[4] This probability is easily derived using elementary probability analysis. According to the definition of the Grade B contour, 50 percent of the television households located near the outer limit of the Grade B contour can receive a reasonably clear picture 90 percent of the time. Let "U" represent the event that a particular household located near the outer limit of the Grade B contour of some broadcast signal falls within the group of households situated to receive a reasonably clear picture of the signal 90 percent of the time. By definition, the probability of U, denoted P(U), is .5. Let V represent the event that a randomly selected household located near the outer limits of the Grade B contour receives a reasonably clear picture at any given time. If the household falls in the best situated group, the probability, denoted as P(V/U), is .9 because households in that group receive a reasonably clear picture of the signal 90 percent of the time. The probability that V occurs is the sum of P(V/U)P(U).

$$\begin{aligned} P(V) &= P(V/U)P(U) \\ &= (.9)(.5) \\ &= .45 \text{ or } 45 \text{ percent} \end{aligned}$$

[5] Let $U_1$, $U_2$ and $U_3$ represent the events that a randomly selected household near the outer limits of the Grade B contour falls within the 50 percent of households situated so that they receive a reasonably clear picture 90 percent of the time of the first, second and third signals, respectively. Assuming complete independence of these events (see note 5 supra), this probability, denoted by $P(U_1U_2U_3)$, is computed as follows:

$$P(U_1U_2U_3) = P(U_1)P(U_2)P(U_3) = (.5)(.5)(.5) = .125$$

Our assumption that these three events are independent is, no doubt, reasonable since the three signals will operate on different frequencies and thus have different propagation characteristics. They may even originate from broadcast stations that are widely dispersed and whose signals thus do not traverse the same geographic terrain or face the same potential interference.

[6] [Deleted]

[7] In many instances, the cable community is so small relative to the size of the Grade B contour that the entire community will be located near the outer limits of the contour. Indeed, the entire community may also be situated such that all of its television households fall within the 50 percent of households located near the outer limits of the Grade B contour which do not receive a reasonably clear signal 90 percent of the time.

[8] Let $U_1$, $U_2$ and $U_3$ represent the event that a randoml selected household near the outer limits of the Grade A contour falls within the 70 percent of households situation so that they receive a reasonably clear picture 90 percent of the time of the first, second and third signals,

respectively. Assuming complete independence of these events (see note 5 supra), the probability of all three events occurring simultaneously, denoted by $P(U_1U_2U_3)$ is computed as follows:

$$P(U_1U_2U_3) = P(U_1)P(U_2)P(U_3) = (.7)(.7)(.7) = .34$$

[9] While much less imperfect than the Grade B contour as a measure of signal availability, the Grade A contour is nevertheless an imperfect measure of signal availability. First, 30 percent of the households located near the outer limit of the Grade A contour will not receive a reasonably clear picture 90 percent of the time. Secondly, the Grade A contour does not take into account geographic terrain that may cause interference of the broadcast signal and prevent its clear reception near the outer limits of the Grade A contour. For these reasons, the Commission must adopt a flexible waiver procedure even if it adopts the Grade A contour as a measure of signal availability.

[10] See note 2, supra.

[11] "Cable TV," Consumer Reports (9/87), pp. 552-53.

[12] We note, however, that the third modification proposed by the Commission--reduction in the number of grid locations at which measurements would be made (Further Notice at ¶ 14)--would actually make it more difficult for cities and towns seeking waivers to establish actual unavailability of broadcast signals.

IN THE CIRCUIT COURT OF KANAWHA COUNTY, WEST VIRGINIA

STATE OF WEST VIRGINIA ex rel.
CHARLES G. BROWN, Attorney
General,

Plaintiff,

v.

Civil Action No. 87-C 659

AMERICAN TELEVISION & COMMUNICATIONS, INCORPORATED, doing
business as Capitol Cablevision,

Defendant.

in Kanawha Circuit Cou.
Clerk's Office

FEB 19 1987

## COMPLAINT

### PARTIES

1. Plaintiff State of West Virginia is a sovereign state, in whose name this action is brought by, and upon the relation of, Charles G. Brown in his official capacity as the Attorney General of the State of West Virginia.

2. Relator Charles G. Brown is the duly elected, qualified, and acting Attorney General of the State of West Virginia and is entitled to bring this action in the name of the State by virtue of the provisions of W. Va. Code §§ 46A-7-108, 46A-7-110, and 47-18-8.

3. Defendant American Television & Communications, Incorporated, is a corporation organized under the laws of the State of Delaware, authorized to do business in the

State of West Virginia, and which does business in the State of West Virginia under the name of Capitol Cablevision.

## JURISDICTION AND VENUE

4. This complaint is filed and the jurisdiction of this Court invoked by plaintiff pursuant to the provisions of W. Va. Code §§ 46A-7-108, 46A-7-110, and 47-18-8.

5. Venue in this Court is proper pursuant to the provisions of W. Va. Code §§ 46A-7-114 and 47-18-15.

## BACKGROUND

6. All the allegations in this complaint concerning the defendant are intended to refer to the defendant's operations conducted under the name Capitol Cablevision, and to activities of the defendant, its subsidiaries, agents, employees, and executives necessary to carry out such operations.

7. The defendant provides services, referred to hereinafter as "cable TV services," consisting of the reception of video signals and the re-transmission of those signals through high-quality, closed-path transmission lines to consumers, termed "subscribers," in return for a monthly service fee.

8. The defendant provides cable TV services to residents of the cities of Dunbar, West Virginia, South Charleston, West Virginia; and Charleston, West Virginia, under franchises granted by the respective municipal governments of those cities.

9. Defendant is the only business entity currently holding a franchise to provide cable TV services in the city of Dunbar, West Virginia.

10. Defendant is the only business entity currently holding a franchise to provide cable TV services in the city of South Charleston, West Virginia.

11. Defendant is the only business entity currently holding a franchise to provide cable TV services in the city of Charleston, West Virginia.

12. Prior to January 26, 1987, and beginning at a time unknown to the plaintiff, the defendant offered three categories or tiers of cable TV service described as follows:

a. "Basic service" consisting of the reception and re-transmission of signals primarily from local television stations, broadcasting at very high frequency (VHF) and ultrahigh frequency (UHF) wavelengths, and from some additional, nonlocal stations or networks;

b. "Tier service" consisting of the reception and re-transmission of signals, originating outside the State of West Virginia, from specialized networks or stations which derive a portion of their revenue from commercial advertising and whose signals are broadcast at microwave frequencies through a network of relay stations and communications satellites; and

c. "Premium services" consisting of the reception and re-transmission of signals, originating outside the State of West Virginia, from premium networks, i.e., Home Box Office, Cinemax, and the Disney Channel, which do not carry commercial advertising and which are broadcast at microwave frequencies through a network of relay stations and communications satellites.

13. The majority of signals or channels included in the Basic service may also be received by consumers with conventional television antennas.

14. Consumers can not receive any of the signals or channels included in the Tier service with conventional television antennas, although some of those signals may be received with parabolic reflector, microwave antennas, commonly known as satellite dish antennas.

15. None of the signals or channels offered by the defendant as Premium services may be received with conventional television antennas; nor can such signals be received for viewing with parabolic reflector, microwave antennas unless the viewer uses special decoding equipment under license from the originators of those signals.

16. Use of unlicensed decoding equipment to view premium, "pay cable" signals is a violation of federal law.

17. Prior to January 26, 1987, subscribers to the Basic service could view all signals provided in that service on a conventional television set.

18. Prior to January 26, 1987, subscribers to the Tier service could only view signals provided in that service with the aid of a cable "converter box."

19. Prior to January 26, 1987, the defendant charged a deposit fee to all subscribers using converter boxes.

20. The defendant currently charges, and has charged throughout the preceding year, a fee of $7.16 per month for subscription to its Basic service and an additional fee of $4.95 for subscription to its Tier service.

21. Prior to January 26, 1987, the defendant provided cable TV services to approximately 30,000 subscribers in its franchise areas, reaching more than seventy-six percent (76%) of the households in the combined areas.

22. Of the defendant's 30,000 subscribers, more than fifty percent (50%), or 15,000 subscribers, chose not to subscribe to the Tier service.

23. On January 26, 1987, the defendant rearranged the assignment of individual signals to various television channels in order to promote and carry out a change in its services, combining the previous Basic service with Tier service to create one category of service termed "Expanded Basic service," eliminating the consumers' option of subscribing to Basic service only.

24. Beginning January 26, 1987, and continuing thereafter, subscribers to the previous Basic service have been unable to receive all of the signals provided in that service on conventional television sets.

25. On various dates, including January 26, 1987, and thereafter, the defendant has advertised, through newspapers of general circulation and through direct mailings to consumers, that the combined service is a "better" version of the previous Basic service and that the fee for the combined service would be $11.95 per month.

26. The defendant has advertised that it will bill subscribers to its previous Basic service at the new, combined rate beginning March 1, 1987.

27. The defendant is taking and has taken steps, such as the distribution of converter boxes and the rearrangement of its signals corresponding to various television channels, to effect the change to the "Expanded Basic service" for all of its subscribers regardless of the subscribers' preferences for the various categories of services.

## COUNT I

28. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and re-alleges the facts set forth in paragraphs 1 through 27 above.

29. By its actions, the defendant has unfairly and deceptively consolidated its services to limit and reduce consumer product options and by incorporating its Basic service and Tier service into one combined service, the defendant has unfairly and deceptively forced a substantial number of consumers to purchase a product which they do not wish to buy.

30. By incorporating its Basic and Tier service into one combined service, the defendant has unfairly and deceptively raised the price of its Basic service to approximately 15,000 consumers.

31. The defendant's actions, set forth in paragraphs 6 through 30 above, are unfair and deceptive acts and practices detrimental and injurious to the public interest and in violation of W. Va. Code § 46A-6-104.

## COUNT II

32. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and re-alleges the facts set forth in paragraphs 1 through 27 above.

33. On various dates on and about January 26, 1987, the defendant has advertised, published, and distributed, and caused to be advertised, printed, displayed, published, distributed, and broadcast, statements and representations with regard to the sale of cable TV services, stating that its new "Expanded Basic service" will cost "only $11.95" per month, that this is an "adjusted" rate for the Basic service, that the change to "Expanded Basic service" expands viewer choices while maintaining the same cost per channel and that this charge will mean a lower bill for those who had subscribed to both the Basic and Tier services.

34. The statements referred to in paragraph 33 above are misleading and deceptive in that they fail to state that the $11.95 monthly charge represents a price increase for subscribers to the previous Basic service, that the amount of the increase is $4.79, which is 66.7% more per month than the previous rate and that the corresponding decrease for subscribers to the Basic and Tier services is only a nominal sixteen cents ($0.16) per month.

35. The actions of the defendant described in paragraphs 6 through 27 and paragraphs 33 and 34 above are unfair and deceptive acts or practices as defined in subsections (12), (13), and (14) of W. Va. Code § 46A-6-102(f), detrimental and injurious to the public interest and in violation of Code 46A-6-104.

## COUNT III

36. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and re-alleges the facts set forth in paragraphs 1 through 27 above.

37. On various dates on and about January 26, 1987, the defendant has advertised, published, and distributed, and caused to be advertised, printed, displayed, published, distributed, and broadcast, statements with regard to the sale of its cable TV services, stating that converter boxes would now be provided to subscribers "free."

38. The statements referred to in paragraph 37 above are false, misleading, and deceptive because they fail to state that subscribers who wish to use a remote control with their television sets must pay four dollars ($4.00) per month for a special converter box and because the defendant has expressed an intention to increase its rates in the future to recoup its costs in providing the thousands of converter boxes necessary to effect the change to the "Expanded Basic service."

39. The actions of the defendant described in paragraphs 6 through 27 and paragraphs 37 and 38, above, are unfair and deceptive acts or practices as defined in subsections (5), (11), (12), (13), and (14) of W. Va. Code § 46A-6-102(f), detrimental and injurious to the public interest and in violation of Code 46A-6-104.

## COUNT IV

40. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and re-alleges the facts set forth in paragraphs 1 through 27 above.

41. The defendant is the sole business entity providing video reception services of premium channel signals within the cities of Charleston, South Charleston, and Dunbar, West Virginia.

42. Premium channel signals are encoded, "scrambled," so that they may only be received by consumers who subscribe to defendant's Premium services.

43. Beginning at a date unknown to the plaintiff and continuing to the present, the defendant has provided its Premium services only upon the condition that the consumer also subscribe to the Basic service.

44. By virtue of the defendant's exclusive position in the market for premium channel reception, the defendant has substantial market power to force consumers of the Premium service to subscribe to the Basic service as well.

45. Defendant's Basic service and Premium service are distinct products for which the defendant charges separate fees and for which there are distinct differences in consumer demand.

46. Tying the purchase of Premium services to the purchase of the Basic service distorts competition in the market for reception of local broadcast signals and restrains trade in consumer alternatives to Basic service such as conventional television antennas and related equipment.

47. Tying the purchase of Premium services to the purchase of Basic service adversely affects more than 5,000 consumers and involves more than $100,000.00 per month in subscription fees.

48. By conditioning the sale of its Premium services upon the additional purchase of the Basic service, the defendant has created and maintained unlawful "tie-in" contracts in restraint of trade and competition in violation of W. Va. Code § 47-18-3(a).

COUNT V

49. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and re-alleges the facts set forth in paragraphs 1 through 27 above.

50. Prior to January 26, 1987, defendant's Tier service consisted of the following special-programming format, microwave networks: Cable News Network, The Nashville Network, Eastern Sports Network (ESPN), Home Shopping Network, Arts and Entertainment Network, Music Television, Christian Broadcasting Network, and Lifetime Health Network.

51. With the exception of the Cable News Network, which uses an electronically scrambled signal, the signals from the networks included in defendant's Tier service may also be received through the use of satellite dish antennas.

52. Under ordinances of the City of Charleston, the City of South Charleston, and the City of Dunbar, West Virginia, businesses and residents in those communities are severely restricted as to where they may have satellite dish antennas.

53. Signals from special-programming format, microwave networks are products distinct from signals from locally broadcast, conventional television frequency stations providing general programming.

54. Defendant's Tier service consists entirely of the reception and re-transmission of signals from special-programming format, microwave networks.

55. Defendant's Basic service consists primarily of the reception and re-transmission of signals from local, conventional television frequency stations providing general programming.

56. Defendant's Tier service and Basic service are distinct products for which the defendant has charged separate fees and for which there are distinct differences in consumer demand.

57. Beginning at a date unknown to the plaintiff and continuing to the present, the defendant has provided its Tier service only upon the condition that the consumer also subscribe to the Basic service.

58. By virtue of the defendant's position as the sole commercial reception service for special-programming format, microwave network signals the defendant has substantial market power in the cities of Dunbar, South Charleston, and Charleston, West Virginia, to force consumers of the Tier service to subscribe to the Basic service as well.

59. Tying the purchase of Tier service to the purchase of Basic service distorts competition in the market for reception of local broadcast signals and restrains trade in consumer alternatives to Basic service such as conventional television antennas and related equipment.

60. Tying the purchase of satellite Tier service to the purchase of Basic service adversely affects more than 12,000 consumers and involves more than $14,340.00 per month in subscription fees.

61. By conditioning the sale of its Tier service upon the additional purchase of Basic service, the defendant has created and maintained unlawful "tie-in" contracts in restraint of trade and competition in violation of Code 47-18-3(a).

COUNT VI

62. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and re-alleges the facts set forth in paragraphs 1 through 27 above.

63. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and realleges the facts set forth in paragraphs 41 through 47 above.

64. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and realleges the facts set forth in paragraphs 50 through 60 above.

65. By conditioning the sale of its Premium services and the sale of its Tier service upon the additional purchase of the Basic service, the defendant has engaged in unfair methods of competition in the market for the reception of local broadcast television signals in violation of W. Va. Code § 46A-6-104.

COUNT VII

66. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and re-alleges the facts set forth in paragraphs 1 through 27 above.

67. The defendant provides discrete services, referred to herein as cable TV services, as its primary business.

68. The defendant is the only provider of commercial cable TV services in the cities of Charleston, South Charleston, and Dunbar, West Virginia.

69. The defendant has announced that it will raise the price of its Basic service by 66.7% and that, after expenses resulting from a change of services, the defendant expects to maintain a reasonable margin of profit.

70. The defendant has substantial power over the price of its services because consumers do not consider other reception products or services to be acceptable substitutes.

71. The defendant maintains a monopoly over the supply of cable TV services within the cities of Charleston, South Charleston, and Dunbar, West Virginia.

72. The imminent restructuring of prices for defendant's Premium services and the imminent increase in the price of its Basic service constitutes use of a monopoly for the purpose of controlling prices in violation of W. Va. Code § 47-18-4.

## PRAYER

WHEREFORE, plaintiff State of West Virginia prays that this Honorable Court will grant the following relief:

1. A preliminary order enjoining the defendant from violating the provisions of W. Va. Code §§ 46A-6-104, 47-18-3(a), and 47-18-4 as described in Counts I through III and Count VI of this complaint, including completing the combination of Basic service and Satellite Tier service into "Expanded Basic service," charging subscribers to the Basic service for the combined service, and all acts, including

advertising, in furtherance thereof during the pendency of this action;

2. Permanent injunctive relief enjoining the defendant from violating the provisions of W. Va. Code §§ 46A-6-104, 47-18-3(a) and 47-18-4 by unlawfully combining its services or conditioning the purchase of one service upon the additional purchase of another service and thereby preventing consumers from making independent purchase choices and forcing consumers to purchase services which they do not desire;

3. Full restitution to each consumer adversely affected by defendant's violations of W. Va. Code § 46A-6-104 described in Counts I-III of this complaint;

4. Appointment of a receiver for the sequestration of liquid assets and to preserve restitution for consumers found to have been damaged by defendant's actions;

5. Civil penalties in the amount of $5,000.00 for each violation of W. Va. Code § 46A-6-104 as set forth in Counts I, II, III, and VI of this complaint;

6. Civil penalties in the amount of $100,000.00 for all violations of W. Va. Code §§ 47-18-3 and 47-18-4 as set forth in Counts IV, V, and VII of this complaint;

7. An award of plaintiff's costs in this action, including, but not limited to, filing fees, witness fees and expenses, and costs related to the production of non-testimonial evidence;

8. An award of reasonable attorney fees and investigative costs for time involved in the investigation and pursuit of this action; and

9. All other orders and judgments the Court shall deem just and proper to effectuate the purposes of the West Virginia Antitrust Act, W. Va. Code § 47-18-1 et seq., the West Virginia Consumer Credit and Protection Act, W. Va. Code § 46A-1-1 et seq., and other general laws of the State of West Virginia.

STATE OF WEST VIRGINIA ex rel.
CHARLES G. BROWN, Attorney
General,
Plaintiff,

By Counsel

Charles G Brown
CHARLES G. BROWN
ATTORNEY GENERAL

MARK KINDT
DEPUTY ATTORNEY GENERAL
State Capitol, Room 26-E
Charleston, West Virginia 25305

Counsel for Plaintiff

STATE OF WEST VIRGINIA,

COUNTY OF KANAWHA, to-wit:

## VERIFICATION AFFIDAVIT

The undersigned, Charles G. Brown, after being duly sworn, deposes and says:

I hereby verify that the allegations set forth in the foregoing complaint are true, except insofar as they are therein stated to be upon information and belief, and insofar as they are stated to be upon information and belief, I believe them to be true.

Charles G Brown
CHARLES G. BROWN

Taken, subscribed and sworn to before me this 19th day of February, 1987.

My commission expires July 19, 1994.

JA[illegible] W. MARTIN
MY COMMISSION EXPIRES JULY 19, 1994

Janette W. Martin
Notary Public

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF WEST VIRGINIA

| | |
|---|---|
| STATE OF WEST VIRGINIA ex rel.<br>CHARLES G. BROWN, Attorney General,<br>Plaintiff,<br>v.<br>AMERICAN TELEVISION AND COMMUNICATIONS CORPORATION, doing business as Capitol Cablevision,<br>Defendant. | Civil Action No. 2:87-0203 |

## MEMORANDUM IN SUPPORT OF MOTION OF AMERICAN TELEVISION AND COMMUNICATIONS CORPORATION TO DISMISS THE COMPLAINT

Defendant American Television and Communications Corporation ("ATC") respectfully submits this memorandum in support of its motion pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure to dismiss the complaint herein.

## PRELIMINARY STATEMENT

This action, brought by the State of West Virginia, alleges that ATC's marketing of cable television programming to consumers violates various provisions of West Virginia's antitrust and consumer protection laws.

ATC seeks the dismissal of the action on the following grounds: (i) five of the seven counts in the complaint (Counts I, IV, V, VI and VII) purport to allege state causes of action that have been expressly pre-empted by federal law; (ii) four of the counts alleging violations of the state antitrust and consumer protection law (Counts IV, V, VI and VII) fail to state claims for relief; and (iii) the counts alleging deceptive practices (Counts I, II and III) are inadequately pleaded under Federal Rule of Civil Procedure 9(b).

## ARGUMENT

### POINT I

### COUNTS I, IV, V, VI AND VII SHOULD BE DISMISSED BECAUSE THE STATE CAUSES OF ACTION ALLEGED HAVE BEEN PRE-EMPTED BY FEDERAL LAW

Under the Supremacy Clause of the United States Constitution, art. VI, cl. 2, the enforcement of a state law is pre-empted by federal law either (i) "when Congress, in enacting a federal statute, has expressed a clear intent to pre-empt state law," Capital Cities Cable, Inc. v. Crisp, 467 U.S. 691, 699 (1984), or (ii) "when the state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," Id. at 699 (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)). See New York State Commission on Cable Television v. Federal Communications Commission, 669 F.2d 58, 62 (2d Cir. 1982).

Under either of these principles, five of the seven state claims asserted in this action should be dismissed because they purport to allege state causes of action that have been recently and explicitly pre-empted by federal law: (i) the Cable Communications Policy Act of 1984 (the "Cable Act"), 47 U.S.C. §§521-559 (Supp. 1987), and (ii) the regulations promulgated thereunder by the Federal Communications Commission (the "FCC"), 47 C.F.R. pts. 1, 63, 76, 78 (1986), as amended, 52 Fed. Reg. 37,461 (1987) (to be codified at 47 C.F.R. § 76.5). Under the scheme of federal and state regulation that this statute establishes for the cable television business, West Virginia (and every other state) is pre-empted from applying its antitrust and consumer protection laws in the manner here attempted.

## A. State Regulation of Cable Television Pricing and Packaging is Pre-empted by the Cable Act

The Cable Act was enacted to "establish a national policy concerning cable communications," to "establish guidelines for the exercise of Federal, State, and local authority with respect to the regulation of cable systems," and to "minimize unnecessary regulation that would impose an undue economic burden on cable systems." 47 U.S.C. §521(1),(3),(6).

One of the primary purposes of the Act is the encouragement of the growth of cable systems, and the promotion of the diversity of their offerings, by "significantly deregulat[ing] the provision of cable service." FCC, Implementation of the Provisions of the Cable Communications Policy Act of 1984, 50 Fed. Reg. 18,637, 18,650 n. 69 (1985).

In furtherance of these goals, the Act establishes a strict allocation of regulatory authority among federal, state and local entities. All state and local law inconsistent with the provisions of the Act is expressly pre-empted:

> "any provision of law of any State, political subdivision, or agency thereof, or franchising authority, or any provision of any franchise granted by such authority, which is inconsistent with this Chapter shall be deemed to be preempted and superseded." 47 U.S.C. §556(c).

Under the regulatory scheme that the Act establishes, a broad category of cable systems is now exempted from any state or local regulation of either (i) the rates charged to cable television customers, or (ii) the manner in which a cable system combines programming for sale to such customers. This is the very kind of conduct to which West Virginia here seeks to apply its laws.

Rate deregulation is governed by Section 623 of the Cable Act. 47 U.S.C. §543. Under the scheme of rate deregulation that the Act establishes, and empowers the FCC to implement through regulations, a cable system is exempted from any rate regulation after December 28, 1986 if it is a cable system found to be subject to "effective competition." 47 U.S.C. §§521 note, 543. As explained in more detail below, the three ATC cable franchises at issue here are subject to "effective competition" within the meaning of the Cable Act, and the FCC regulations promulgated thereunder, and plaintiff has not alleged to the contrary in the complaint.

Pursuant to the scheme of deregulation established by the Cable Act, the regulation of cable rates is permitted for only a limited category of cable systems. See 50 Fed. Reg. 18,654 (1985) ("the majority of cable systems will be exempted from all rate regulation"). It is clear that Congress intended that this deregulation not be frustrated by inconsistent state law. In addition to the Act's general pre-emption of inconsistent state law, 47 U.S.C. §556(c), the section governing rate deregulation expressly provides that a state "may not regulate rates for the provision of cable service except to the extent provided under this section." 47 U.S.C. §543(a).

The rate deregulation effected by the Act was implemented according to a carefully defined timetable. During the first two years following the Act's effective date -- December 29, 1984 -- limited regulation of rates was allowed. 47 U.S.C. §543(c). After this period -- in other words after December 28, 1986 -- rate regulation is allowed only for those cable systems that fall within the regulations issued by the FCC. 47 U.S.C. §543(b).

The Act instructed the FCC to (i) promulgate regulations to "define the circumstances in which a cable system is not subject to effective competition," 47 U.S.C. §543(b)(2)(A), and (ii) "prescribe and make effective regulations which authorize a franchising authority to regulate rates for the provision of basic cable service in circumstances in which a cable system is not subject to effective competition." 47 U.S.C. §543(b)(1). Pursuant to this regulatory framework, a cable system's rates are -- after December 28, 1986 -- exempted from any rate regulation if the system falls within the category, as defined by the FCC, of cable systems subject to "effective competition." 47 U.S.C. §543. If rate regulation is permissible because the cable system is not subject to "effective competition," it is only the "franchising authority" that is granted the power to conduct such regulation. See 47 U.S.C. §543(a); 47 C.F.R. § 76.33 (1986).* A state, in other words, cannot conduct such regulation if it is not the franchising authority.

The policy of deregulation established by the Cable Act also guarantees cable systems the freedom to rearrange the packaging of their cable programming. The Act defines any of the packages of cable television programming that a cable system offers to its customers -- for example, a package combining both network programming and a premium channel, like HBO -- as a "service tier." 47 U.S.C. §522(14). The Act expressly provides that if a cable system is not subject to rate regulation, it is also not subject to regulation concerning the composition of the service tiers it offers its customers. 47 U.S.C. §545(d). See 50 Fed. Reg. 18,654 (1985) (explaining that "[§545(d)] gives cable operators complete freedom to retier and repackage programming services among the tiers that are exempted from rate regulation").

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* The provision governing rate deregulation expressly provides that it is only the "franchising authority" which "may regulate the rates for the provision of cable service . . . to the extent provided under this section." 47 U.S.C. §543(a). It also provides that "[a]ny Federal agency or State may not regulate the rates for the provision of cable service except to the extent provided under this section." 47 U.S.C. §543(a). See also 47 U.S.C. §541(c) ("Any cable system shall not be subject to regulation as a common carrier or utility by reason of providing any cable service.").

It is clear that under this careful allocation of regulatory authority established by Congress, the State of West Virginia is pre-empted from regulating either the rates or the program packaging of the three ATC franchises at issue in this lawsuit.

### 1. The ATC Franchises at Issue Are Exempted From Any Regulation of Rates and Packaging

The FCC has issued regulations that allow cable systems to determine whether they are subject to "effective competition," and thus exempt from any regulation of either the rates charged to customers or the manner in which their products are packaged. 47 C.F.R. §76.33 (1986).

The three ATC cable franchises whose practices are challenged by the complaint in this action qualify, under the FCC's current regulations, as subject to "effective competition." They are accordingly, under the scheme of the Cable Act, exempt from regulation of either (i) the rates charged to their customers or (ii) the manner in which their programming is packaged for sale. See 50 Fed. Reg. 18,654 ("When the Commission's rules become effective after the two-year transition period, the majority of cable systems will be exempted from all rate regulation. Most cable operators will, therefore, have complete freedom to retier and repackage all of their 'basic' and 'pay' programming services.").*

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* The current FCC regulations provide, in substance, that a cable system is subject to effective competition if three or more broadcast signals, not duplicative of one another, serve the community. 47 C.F.R. §76.33 (1986). This standard is satisfied if three or more signals "place a Grade B contour . . . over any portion of the cable community." Id. The concept of a "Grade B contour" refers to a manner of plotting the predicted strength of a broadcast signal over the geographic area that it serves. See 47 C.F.R. § 73.683(a). Neither the Act, nor the regulations, require a cable system to receive FCC confirmation of its determination that its community is served by a sufficient number of signals. Indeed, the FCC favors a "presumption that competition does in fact exist." 50 Fed. Reg. 18,651. If the franchising authority believes that "such signals are not in fact available within the community," 47 C.F.R. §76.33(a)(2), it "may petition the Commission for relief." 47 C.F.R. §76.33(e).

Under the Grade B contours for West Virginia that are filed with the FCC, the three cable franchises at issue in this lawsuit qualify as subject to "effective competition." See Television Digest's Cable & Station Coverage Atlas, map 103 (1987). None of the franchise authorities have requested the FCC to classify them otherwise.

In American Civil Liberties Union v. Federal Communications Commission, 823 F.2d 1554 (D.C. Cir. 1987), the Court of Appeals for the District of Columbia Circuit found that because of the inherent difficulties of measuring signal availability, it was incumbent upon the FCC to

### 2. The Cable Act Pre-empts the State of West Virginia from Regulating Cable Rates and Packaging

Even if the three ATC cable franchises at issue in this lawsuit were not subject to "effective competition" as defined by the FCC regulations, and thus were not exempt from some regulation of rates or program packaging, the State of West Virginia would still be preempted -- under the careful allocation of regulatory authority created by the Cable Act -- from conducting such regulation itself.

Pursuant to the strict regulatory scheme established by the Cable Act, it is only the "franchising authority" which is granted the authority to regulate the

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craft a standard that would "ensure that a signal is at least theoretically available over the entire cable community or at least some significant portion of the cable community." 823 F.2d at 1572. Accordingly, the Court remanded the issue to the agency for either "a reasoned explanation of its chosen standard or the development of a new standard." Id. at 1573.

Responding to the court's concerns, the FCC, in a notice of proposed rulemaking, has announced that it proposes to amend its current regulations to provide that "a cable system faces effective competition if at least 75 percent of the cable community" is covered by the Grade B contours of three or more broadcast signals. 52 Fed. Reg. 36,802 (1987). If this new standard is adopted to replace the current standard, the three cable franchises at issue in this lawsuit will continue to qualify as subject to "effective competition."

rates and program packaging of a cable franchise. See 47 U.S.C. §§543 and 545.

Plaintiff's complaint does not -- and cannot -- allege that it is the "franchising authority" for any of the three franchises at issue in this lawsuit. See Compl. ¶8 (alleging that the franchises were "granted by the respective municipal governements" of Dunbar, South Charleston and Charleston). Since it is not the franchising authority, the State of West Virginia is pre-empted by the Cable Act from regulating the rates or program packaging of these franchises.

## B. Application of West Virginia's Antitrust and Consumer Protection Laws to ATC's Pricing and Tiering is Pre-empted

Under the regulatory scheme established by Congress in the Cable Act, five of the seven causes of action asserted in the complaint in this action should be dismissed because they are pre-empted by federal law. They represent West Virginia's effort to regulate the rates and program offerings of ATC's three cable franchises in contravention of the Cable Act by applying state law to pricing and packaging conduct that Congress has declared shall be exempt from state regulation.*

Counts I and VII address the prices which ATC's three cable franchises are charging their customers. Count VII, for example, alleges that "the imminent increase in the price" of one of ATC's cable television products, and the "imminent restructuring of prices" for others, constitutes a violation of the West Virginia antitrust laws. The charge, in short, is that the prices are too high. Plainly, this is an effort to apply state law to regulate cable television pricing -- conduct that the Cable Act, and the FCC's regulations thereunder, have exempted from state regulation.**

Counts I, IV, V and VI address the manner in which ATC's three cable franchises have combined cable television programming into packages -- or service tiers -- for sale to their customers. Count VI, for example, charges that the West Virginia consumer protection law is violated by ATC's "conditioning the sale of . . . its Tier service upon the additional purchase of the Basic service." As the factual allegations of ¶23 of the Complaint elaborate, this violation has allegedly been accomplished by "combining the previous Basic service with Tier service to create one category of service termed 'Expanded Basic service.'" Once again, this plainly represents an effort to apply state law to regulate the packaging of cable television products -- conduct that the Cable Act has also exempted from state regulation.*

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* Two of the seven causes of action -- Counts II and III -- allege violations concerning ATC's advertising of its cable television products and are not pre-empted under the scheme of regulatory authority established by the Cable Act. 47 U.S.C. §558.

** Count I represents a similar effort to regulate cable television pricing by alleging that the manner in which ATC has incorporated its Basic and Tier service into one combined service has "raised the price of its Basic service" in violation of West Virginia's consumer protection laws. Compl. ¶ 30.

Pursuant to the well developed principles of pre-emption under the Supremacy Clause, these applications of state law have been pre-empted by federal law.

First, Congress, in enacting the Cable Act, "has expressed a clear intent to pre-empt state law." Capital Cities Cable, Inc. v. Crisp, 467 U.S. 691, 699 (1984).

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* Counts I, IV and V represent a similar effort to regulate the manner in which ATC has combined its television programming into packages. Count I alleges that ATC has violated West Virginia's consumer protection laws by "incorporating its Basic service and Tier service into one combined service." Compl. ¶29. Count IV alleges that ATC has violated West Virginia's antitrust law by "conditioning the sale of its Premium services upon the additional purchase of the Basic service." Compl. ¶48. Count V alleges that ATC has violated West Virginia's antitrust laws by "conditioning the sale of its Tier service upon the additional purchase of Basic service." Compl. ¶61.

The Act unequivocally provides that there shall be no regulation of the pricing and packaging of cable television products provided by cable systems, such as ATC, that are subject to effective competition, and it expressly pre-empts inconsistent state law. See 47 U.S.C. §§543(a), 556(c). It is clear that Congress contemplated that the state laws pre-empted would include not only laws directed to cable television alone, but also laws of general applicability -- like antitrust and consumer protection laws -- that, although valid in many other applications, might be subsequently applied to cable television. Section 632 of the Act, for example, provides that: "Nothing in this subchapter shall be construed to prohibit any State or any franchising authority from enacting or enforcing any consumer protection law, to the extent not inconsistent with this subchapter." 47 U.S.C. §552(c) (emphasis supplied).

The Act also provides that it is only the franchising authority -- which, in this case, is not the State of West Virginia -- that may conduct such regulation even when regulation is permissible. See 47 U.S.C. §§543 and 545.

Second, it is well established that the Supremacy Clause prohibits applications of state law that would frustrate federal policy. See, e.g., Capital Cities Cable, Inc. v. Crisp, 467 U.S. 691, 699 (1984); New York State Commission on Cable Television v. Federal Communications Commission, 669 F.2d 58, 62 (2d Cir. 1982); Brookhaven Cable TV, Inc. v. Kelly, 573 F.2d 765, 767 (2d Cir. 1978), cert. denied, 441 U.S. 904 (1979). In Capital Cities Cable, Inc. v. Crisp, 467 U.S. 691 (1984), for example, the Supreme Court held that the application to cable television of an Oklahoma statute banning liquor advertising was pre-empted by the clear federal policy "to allow unfettered importation of distant broadcast signals." 467 U.S. at 704. "[T]he full accomplishment of such objectives," the Court reasoned, "would be jeopardized if state and local authorities were now permitted to restrict substantially the ability of cable operators to provide these diverse services to their subscribers." 467 U.S. at 704.

The application of these West Virginia statutes to ATC's cable television business would stand "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." Capital Cities Cable, Inc. v. Crisp, 467 U.S. 691, 699 (1984) (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)). Plainly, application of West Virginia's antitrust and consumer protection laws to attempt to control ATC's pricing and packaging policies would have the effect of regulating the very conduct that Congress has specifically deregulated, and thus would nullify the key provisions of the Cable Act. Since Congress has decided that West Virginia can no longer regulate ATC's pricing and packaging directly, West Virginia cannot be allowed to do so indirectly through the application of its antitrust and consumer protection laws.

Accordingly, Counts I and VII should be dismissed because they rely upon state antitrust and consumer protection law to regulate the price of ATC's products and such an application of state law has been pre-empted by the Cable Act. Similarly, Counts I, IV, V and VI should be dismissed because they rely upon state antitrust and consumer protection law to regulate the manner in which ATC has combined cable television programming into packages and such an application of state law has also been pre-empted by the Cable Act.

## POINT II

## COUNTS IV, V, VI AND VII SHOULD BE DISMISSED BECAUSE THEY FAIL TO STATE CAUSES OF ACTION UNDER THE WEST VIRGINIA ANTITRUST ACT AND CONSUMER PROTECTION ACT

Counts IV, V, VI and VII should be dismissed for the additional reason that they fail to state causes of action under the governing authorities.

Plaintiff has alleged, in Counts IV, V and VII of the complaint, that ATC has violated the West Virginia Antitrust Act, W.Va. Code §47-18-1 - §47-18-23 (1986), by (i) the manner in which it has packaged its programming for sale to cable television customers, and (ii) the rates which it is charging cable television customers.

These allegations -- although framed as violations of West Virginia antitrust law -- are governed by the well developed principles of federal antitrust law. The West Virginia Antitrust Act expressly provides that it shall be construed "in harmony with ruling judicial interpretations of comparable federal antitrust statutes." W.Va. Code §47-18-16. Under the well established principles of federal antitrust law, the allegations in Counts IV, V and VII should be dismissed because they fail to state a cause of action.

### A. ATC's Packaging of its Cable Television Programming is Not An Illegal Tying Arrangement

Plaintiff charges in Counts IV and V that ATC, by requiring customers to subscribe to Basic Service before they can receive Tier service or Premium service, has created an illegal tying arrangement. See Compl.

¶¶48, 61. These claims should be dismissed because they fail to state a cause of action under the well established body of law defining the types of tying arrangements that violate the antitrust laws.

The Supreme Court has explained that a tying arrangement may raise concerns about competition because a tying arrangement -- that is, the requirement that a customer who desires to purchase a first product (referred to as the tying product) must also purchase a second product (referred to as the tied product) -- may, in some circumstances, result in a restraint on "competition on the merits in the market for the tied item." Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2, 12 (1984). Competition is lessened, in other words, because customers are denied an alternative choice and competitors selling the tied product are denied an opportunity for a sale.

Consistent with this rationale, courts have required that an anticompetitive effect in the market for the tied product -- here, the sale of basic cable service -- be demonstrated before a tying arrangement will be found illegal under the antitrust laws. See Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 6 (1958); Crossland v. Canteen Corp., 711 F.2d 714, 722 (5th Cir. 1983); B.C.

Recreational Indus. v. First Nat. Bank, 639 F.2d 828, 832 (1st Cir. 1981).

The courts have recognized that where there are no competitors selling the tied product, an alleged tying arrangement does not violate the antitrust laws because no customers or competitors are injured and no competition is thus restrained. See, e.g., Friedman v. Adams Russell Cable Servs. - New York, Inc., 624 F. Supp. 1195 (S.D.N.Y. 1986); see also Community Builders, Inc. v. City of Phoenix, 652 F.2d 823, 830 (9th Cir. 1981); Coniglio v. Highwood Services, 495 F.2d 1286, 1291-93 (2d Cir.), cert. denied, 419 U.S. 1022 (1974); Driskill v. Dallas Cowboys Football Club, Inc., 498 F.2d 321, 323 (5th Cir. 1974).

In Friedman v. Adams Russell Cable Services - New York, Inc., 624 F.Supp. 1195 (S.D.N.Y. 1986), the court relied upon these principles to dismiss a tying claim identical to that alleged here. In that case the defendant cable television company had the same policy as the one alleged here: it required customers who desired to receive a premium cable service to also subscribe to an additional tier of cable service. 624 F. Supp. at 1196. The plaintiff contended that this policy violated the Sherman Act by creating an illegal tying arrangement. Id. The Court held that the Sherman Act was not violated because the cable company had a lawful monopoly and thus there was no anticompetitive effect in the sale of the tied product. Id. It explained that because the defendant "enjoys an absolute lawful monopoly in the relevant geographic market for the tied product," there were no competitors providing cable services in that community to be harmed by the arrangement; thus, the Court concluded, "the elements of a cause of action are not made out." Id.

Under these principles, the tying allegations set forth in the complaint in this action cannot, as a matter of law, establish an antitrust violation because there are no competitors in the specific tied product at issue -- basic cable service -- to be injured. The complaint alleges that ATC is the only company offering cable television services in the three communities at issue. Complaint, ¶¶ 9, 10, 11. In view of the facts alleged, there are no competitors offering cable service who are harmed by the challenged conduct and no customers who are denied the choice of an alternative cable service.*

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* Plaintiff cannot avoid these well developed principles by suggesting that it is the providers of "conventional television antennas and related equipment" who are harmed. Compl. ¶¶46, 59. A tying violation requires a showing that the challenged practice will "restrain free competition in the market for the tied product." Northern

Since plaintiff cannot state a claim under West Virginia's Antitrust Act, Counts IV and V of the complaint should be dismissed.*

B. ATC's Price Increase is Not Monopolizing Conduct

Plaintiff charges in Count VII that ATC, by raising the prices it charges cable television customers, has violated the antitrust laws by using "a monopoly for the purpose of controlling prices." Complaint ¶72.

This claim should be dismissed because, under the well recognized principles of antitrust law, plaintiff does not allege -- nor could it allege -- that ATC has engaged in any conduct which could be held to constitute illegal monopolization.

It is well established that the "monopolizing"

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Pacific Railway Co. v. United States, 356 U.S. 1, 6 (1958) (emphasis supplied). Conventional television antennas are not the tied product that plaintiff has identified. The tied product at issue here is a tier of cable television service. No consumer, in other words, is alleged to have been required to purchase a particular television antenna as a result of the challenged practice.

* Plaintiff also charges, in Count VI, that the alleged tying arrangement violates the West Virginia Consumer Protection Act. The West Virginia legislature has indicated that this Act is also to be construed in harmony with federal law, see W. Va. Code §46A-6-101(1), and thus Count VI should also be dismissed for the reasons set forth above.

behavior which is proscribed by the antitrust laws is the *achieving* or *maintaining* of monopoly power by an "exclusionary practice" -- that is, by conduct that is immoral or predatory or otherwise not "honestly industrial." III P. Areeda & D. Turner, *Antitrust Law* ¶ 613 (1978). *See* *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966); *United States v. Griffith*, 334 U.S. 100, 106-7 (1948).

Plaintiff has made no allegation that ATC has succeeded as the sole provider of cable services in the communities at issue by illegal conduct. ATC has been granted its position in the provision of cable television in the communities it serves pursuant to franchise agreements whose validity plaintiff does not even question.

Plaintiff has also made no allegation that ATC has maintained its position in these communities by illegal conduct. The kind of pricing policy that has been held to constitute illegal monopolization is only predatory pricing -- that is, price decreases which unfairly destroy or eliminate competitors. *See*, *e.g.*, *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 668 F.2d 1014, 1035 (9th Cir. 1981), *cert*. *denied*, 459 U.S. 825 (1982). The only allegation which plaintiff has made -- that ATC increased its prices -- is not an allegation of such predatory or exclusionary conduct and will not support a claim that ATC has engaged in illegal monopolization. If plaintiff's theory were accepted, no cable system, or any other firm with a legitimately obtained market position, could ever increase its prices for any reason.

In sum, Count VII should be dismissed because plaintiff has failed to allege any predatory or exclusionary conduct. The federal courts have long recognized that a competitor who has achieved a successful position in the marketplace has not, by virtue of that position alone, illegally monopolized the marketplace. See, e.g., Union Leader Corporation v. Newspapers of New England, Inc., 284 F.2d 582, 584 (1st Cir. 1960), cert. denied, 365 U.S. 833 (1961).

## POINT III

### PLAINTIFF'S CONSUMER PROTECTION ACT CLAIMS IN COUNTS I, II AND III SHOULD BE DISMISSED AS INADEQUATE UNDER FED. R. CIV. P. 9(b)

Rule 9(b) of the Federal Rules of Civil Procedures requires that "[i]n all averments of fraud . . . the circumstances constituting fraud . . . shall be stated with particularity." The allegations in plaintiff's complaint regarding ATC's purportedly "deceptive" business and advertising methods -- set forth in Counts I, II and III -- are required to meet the rigors of Rule 9(b). See Hayduk v. Lanna, 775 F.2d 441, 443 (1st Cir. 1985); Felton v. Walston & Co., 508 F.2d 577, 580 (2d Cir. 1974). Plaintiff's allegations must be dismissed because they fail to meet this standard.*

Rule 9(b) mandates that the party pleading fraud must, at the least, "specify the time, place and content of any allegedly false representation." 2A J. Moore, Moore's Federal Practice ¶9.03, at 9-20 through 9-23 (1987); see also Owen v. Commercial Union Fire Ins. Co., 211 F.2d 488, 489 (4th Cir. 1954); Copiers Typewriters Calculators, Inc. v. Toshiba Corp., 576 F. Supp. 312, 327 (D. Md. 1983); Robinette v. Griffith, 483 F. Supp. 28, 31 (W.D. Va. 1979).

Plaintiff's complaint utterly disregards these obligations. Nowhere in the complaint does plaintiff disclose the time or place at which ATC disseminated its allegedly misleading statements or the complete content of those statements.

ATC has the right to know what, if any, statements plaintiff would point to as the basis for its charge of unfair and deceptive practices, and without such information, ATC is unable to respond or prepare effectively should it be required to do so. See Greenwood v. Dittmer, 776 F.2d 785, 789 (8th Cir. 1985) ("One of the primary purposes of [Rule 9(b)] is to facilitate a defendant's ability to respond to and to prepare a defense to a plaintiff's charges."); Ross v. A.H. Robins Co., 607 F.2d 545, 557-58 (2d Cir. 1979) ("A defendant is entitled to a reasonable opportunity to answer the complaint and must be given adequate information to frame a response."), cert. denied, 446 U.S. 946 (1980).

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* Although state law governs the burden of proving fraud at trial, the procedure for pleading fraud in federal courts is governed by Rule 9(b). Hayduk v. Lanna, 775 F.2d 441, 443 (1st Cir. 1985).

Plaintiff's deficient pleading, for example, causes ATC particular hardship in responding to the allegations of Count III. There plaintiff charges that ATC's statement that it will provide free converter boxes is misleading and deceptive because ATC has "expressed an intention to increase its rates in the future to recoup its costs in providing the thousands of converter boxes necessary to effect the change to the Expanded Basic Service." Compl. ¶38. Since plaintiff fails to specify just when ATC expressed this intention, ATC is obviously unfairly disadvantaged in answering or defending against the allegation.

Where the pleading requirements of Rule 9(b) are not met, dismissal of the complaint is an appropriate response, and one that should be applied in this case. See, e.g., Hayduk v. Lanna, 775 F.2d 441, 445 (1st Cir. 1985); Barry v. St. Paul Fire & Marine Ins. Co., 555 F.2d 3 (1st Cir. 1977), aff'd, 438 U.S. 531 (1978); Robinette v. Griffith, 483 F. Supp. 28, 31 (W.D. Va. 1979).

## CONCLUSION

Plaintiff's complaint should be recognized for what it is, a blatant attempt to avoid the clearly expressed will of Congress. For all of the reasons set forth above, the motion by American Television and Communications Corporation to dismiss the complaint should be granted.

Dated: New York, New York
December 18, 1987

Respectfully submitted,

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IN THE UNITED STATES DISTRICT COURT FOR
THE SOUTHERN DISTRICT OF WEST VIRGINIA

At Charleston

BY [illegible]
DEPUTY

STATE OF WEST VIRGINIA
ex rel. CHARLES G. BROWN,
Attorney General,

Plaintiff,

v.

CIVIL ACTION NO. 2:87-0203

AMERICAN TELEVISION AND
COMMUNICATIONS CORPORATION,
doing business as Capitol
Cablevision,

Defendant.

# PLAINTIFF'S RESPONSE TO DEFENDANT'S MOTION TO DISMISS

## I.

## INTRODUCTION

For most of the past year, the State of West Virginia has attempted to convince this Court of the full force and weight of that mandate which requires a federal court to discover its removal jurisdiction solely on the face of a well pleaded complaint or in the plain language of a statutory grant of exclusive jurisdiction to the federal courts over the particular subject matter of the litigation. As

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federal courts are courts of limited jurisdiction, these basic but imperative considerations are absolute prerequisites for permitting state claims to enter the federal forum. To date, the defendant has not met its burden of proof on the existence of removal jurisdiction, nor has the Court ruled on the pending petitions for remand argued by the State.

Given the continuing delay in the Court's decision on the pending remand petitions, both the State of West Virginia and defendant have sought to postpone the application of a time frame order to this litigation. However, despite the best efforts of both parties, the Court has now required, pursuant to that order, that defendant file its motion to dismiss under Rule 12(b) of the Federal Rules of Civil Procedure. The State of West Virginia files its response herein to the defendant's instant motion without conceding the jurisdiction of this Court to preside over the present case or to rule upon the motion to dismiss now pending before it.

The State further objects to the concurrent consideration by this Court of a procedural motion to remand and a substantive motion to dismiss. The former deals with basic preliminary and necessary elements of jurisdiction. The latter seeks to plumb the substantive legal merits of the State's case. See, Section II, infra. In short, the State files this response simply to avoid any appearance of disrespect for the otherwise legitimate power of this Court, and to avoid any prejudice to the State's claims which might result if it chose to remain silent in the face of a pending motion to dismiss.

The law and argument presented here will demonstrate to the Court that it is without removal jurisdiction to hear the pending motion to dismiss. This lack of federal jurisdiction will become obvious as the Court ponders the jurisdictional defects which will result from any failure to remand the case to state court. For good cause shown, the State of West Virginia respectfully requests that the instant case, along with the pending motion to dismiss, be remanded to the only forum where jurisdiction lies, the Circuit Court of Kanawha County, West Virginia.

## II.

## THE PRACTICE BY THE COURT IN THE PRESENT CASE, OF PROCEEDING TO CONSIDER MOTIONS TO DISMISS WITHOUT FIRST HAVING ESTABLISHED ITS REMOVAL JURISDICTION THROUGH A RULING ON PENDING MOTIONS TO REMAND, IS INCORRECT AND CONSTITUTES VACATABLE ERROR.

The Court's requirement in the present case, that defendant file, and that the State respond to, a motion to dismiss before the most fundamental of all elements of federal jurisdiction has been established, stands in direct contravention of the basic principles of federalism and judicial restraint on which the limited jurisdiction of the federal courts has always rested. See, Marbury v. Madison, 5 U.S. (1 Cranch) 137 (1803). The highest of authorities modern federal civil procedure have long recognized the fundamental error inherent in this specific combination of the removal jurisdiction decision and the decision of whether to dismiss based on the merits.

Professor Moore makes the distinction clear when he states that "remand is appropriate when the federal court lacks subject matter jurisdiction over the proceeding, while dismissal involves an act of power in relation to the proceeding when the federal court has subject matter jurisdiction." 1A Moore's § 0.168 [4. - 1], p. 649 (1987).

Therefore, in "applying §1447(c), a distinction must be made between the federal court's lack of jurisdiction and the plaintiff's failure to allege a claim upon which relief can be granted," and once removal jurisdiction is established, "the federal court with [removal] jurisdiction can order dismissal of the claim." Id., § 0.169[1], p. 681.[1] Wright & Miller reinforce this analysis of the distinct dichotomy between the removal and dismissal decisions when they state that "[a] federal court presented with a motion to remand is limited solely to the question of its authority to hear the case pursuant to the removal statute." 14A Wright & Miller, § 3739, p. 580. Therefore, "the court must be certain that federal jurisdiction is proper before entertaining a motion by defendant to dismiss plaintiff's complaint for failure to state a claim upon which relief may be granted." (Emphasis added) Id., § 3739, pp. 572-573 (1985).

Beyond secondary sources, well defined legal authority at the federal appellate level has also long held that visiting the merits of a claim, through a motion to dismiss, prior to determining a pending remand petition, is an incorrect and wasteful procedure. At least five federal circuits have faced this issue on review and each time they have vacated a district court's dismissal order whenever it has been muddled together with an otherwise dispositive remand decision. The clearest appellate court case on point, and one which has often been cited by subsequent federal courts faced with the same issue, is In re Bear River Drainage District, 267 F.2d 849 (10th Cir. 1959).

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[1] 28 U.S.C. 1447(c) reads as follows:

(c) If at any time before final judgment it appears that the case was removed improvidently and without jurisdiction, the district court shall remand the case, and may order the payment of just costs. A certified copy of the order of remand shall be mailed by its clerk to the clerk of the State court. The State court may thereupon proceed with such case.

The Bear River case concerned a proceeding instituted by the State Engineer of Utah, in the Utah state courts, to determine the use of all the waters within the Bear River drainage in Utah. Id., at 849. The United States was served as a party to the case and it in turn filed for removal to the federal district court. Id. In response, the State Engineer moved to remand the case to state court while the United States filed a motion to dismiss. Id., at 850. The Tenth Circuit, on review, put the matter plainly when it stated, "[w]hile the questions involved in the two motions were necessarily related, the better practice would have been to rule first on the motion to remand and if granted to have sent the motion to dismiss back to the state court." Id., at 851. Of course, in the present case defendant's Rule 12(b) motion is not one challenging jurisdiction, which would otherwise serve to parallel the remand decision as in the Bear River case, but instead seeks to open the merits of the State's claim. Therefore, as precedent for the present case, the Bear River language takes on an even greater imperative.

Opinions in other circuits have indeed put the matter in more jussive terms. In a case which predates Bear River by more than thirty years, the Second Circuit also addressed the problematic practice of a federal court's assertion of jurisdiction to hear motions with substantive effect on the litigation prior to establishing its basic removal jurisdiction. Marchant v. Mead-Morrison Mfg. Co., 11 F.2d 368 (2nd Cir. 1926). Marchant involved an appeal by a bankruptcy trustee whose application for appointment of an arbitrator had been dismissed by the federal district court at the same time that the court had ordered the case remanded to state court. Id., at 368-369. In nullifying the district court's order to dismiss the application, the Second Circuit noted that, "[t]he motion to remand raised a question of jurisdiction; decision was against jurisdiction; therefore proper practice was to send the matter at once, and as it was [prior to consideration of the application], to the place where jurisdiction existed [i.e., the state court]. The second part of the order under review [dismissing the application] was improper." Id., at 369.

The First Circuit has faced the remand/dismissal question in a suit by a divorced husband arising out of a dispute with respect to his obligations under a memorandum of understanding with his former wife. Armstrong v. Armstrong, 508 F.2d 348 (1st Cir. 1974). In its decision, which vacated the district court's order of dismissal and instructed the district court to enter an order remanding the action to state court, the First Circuit held that where the district court, after removal of the case to a federal forum, had determined that the action could not be entertained within the limits of federal jurisdiction, the case should have been remanded to state court rather than dismissed. Id., at 351, citing 1A Moore's Federal Practice § 0.169[1].

The Ninth Circuit has recently taken the opportunity to address, at least in passing, the issue of remand-versus-dismissal and found that remand is preferable to the unnecessary complication brought to the task of appellate review and future litigation by a synthesis of the two disparate decisions. Chism v. National Heritage Life Ins. Co., 637 F.2d 1328 (9th Cir. 1981). In Chism, the Ninth Circuit reviewed a district court's grant of dismissal for failure by the plaintiff to answer two sets of interrogatories.

Id., at 1329. Subsequently, the plaintiff filed a motion to remand. Although the circuit court found that the district court's assertion of removal jurisdiction was proper, it took the time to deliver the district court a terse message about jurisdiction and proper procedure in the federal courts: "Although appellant presented [a remand motion] to the district court, it was not acted upon there. We granted permission to present the motion here. It would have been well had the district court acted upon the challenge to its jurisdiction before exercising it by dismissal." Id., at 1330, n. 3.

In the most recent court of appeals case on point, the Seventh Circuit reviewed a district court's order of dismissal for lack of subject matter jurisdiction which was considered and granted by the lower court prior to its ruling on a pending remand motion. Allen v. Ferguson, 791 F.2d 611 (7th Cir. 1986). In reversing the lower court's order, the Seventh Circuit pointed out that when faced with both a remand and a dismissal motion, "[F]ederalism concerns tip the scales in favor of initially ruling on the motion to remand. In passing on [the defendant's 12(b)] motion, the district court was required to delve into difficult questions of [state law]. It should not have considered these issues when it was presented with a federal question of at least equal, if not less, difficulty relating to [federal subject matter jurisdiction under the removal statute]." Id., at 616.

The most recent update of Bear River by the Tenth Circuit has incorporated a long-standing Supreme Court rationale to reinforce the need for remand prior to dismissal. In City of Waco v. United States Fidelity & Guaranty Co., 293 U.S. 140 (1934), the United States Supreme Court reviewed a case where the district court had granted a motion to dismiss a party to the action which resulted in a destruction of the diversity basis for federal subject matter jurisdiction. Lacking diversity after the dismissal, the district court then remanded the action to state court. Id. In overturning the Fifth Circuit's decision to uphold the lower court's actions, the Supreme Court was concerned with the confusion produced by a dismissal followed by a remand. This confusion arose from the case law rule which holds that a federal court's order to remand is not appealable, meaning that the cause of action would return to state court with a federal dismissal of some undefined legal force floating on the periphery of the case. Id., at 143.

The Tenth Circuit, in Kromer v. McNabb, 308 F.2d 863 (10th Cir. 1962), characterized the Waco ruling as being concerned with maintaining the original state court case "intact" after removal is complete. Id., at 865. In other words, the decisions in Waco and Kromer show the convolutic in the process of federal court adjudication when remand an dismissal are lumped together. These appellate courts were forced to vacate the district courts' orders of dismissal, not on the merits of such orders, but simply in order to maintain the continuity of issues when the cases were remanded to state court for lack of removal jurisdiction. Of course, both cases would have remained "intact" if the district courts in each case had addressed the respective remand petitions in an exclusive and timely manner.

Most federal district courts over the past half centu when faced with the same issue, have remanded with no hesitation about whether to reach the dismissal question. In the Matter of the Marriage of Smith, 549 F. Supp. 761 (D.C.W.D. Tex. 1982) ("The proper remedy is not to dismiss, but to remand to state court"); Cannon v. United Insurance

Company of America, 352 F. Supp. 1212 (D.S.C. 1973) ("Jurisdiction should never be dependent on the speculation of the trial court as to the final outcome. . . The removal statutes were never intended or designed to enlarge Federal jurisdiction"); Oil Well Service Co. v. Underwriters at Lloyd's London, 302 F. Supp. 384 (D.C.C.D. Cal. 1969) ("Upon motion to remand to the State Court, the Federal Court is limited solely to the question of jurisdiction. [cites omitted] If Federal jurisdiction is doubtful, the case will be remanded. [cites omitted]"); Jacobs v. District Director of Internal Revenue, 217 F. Supp. 104 (S.D.N.Y. 1963) ("While dismissal of the complaint is the usual procedure where a court lacks jurisdiction over the subject matter, the better course in a removed action is to remand the suit to the state court from which it was removed."); Babb v. Paul Revere Life Ins. Co., 102 F. Supp. 247 (W.D.S.C. 1952) ("I may not pass upon the sufficiency of the allegations as upon demurrer or upon motion to dismiss for failure to state a cause of action, since I am limited solely to the question of jurisdiction. If it should be held by the state court that the allegations are not sufficient to sustain a charge of joint liability against all three defendants, it would be the prerogative of the state court to dismiss upon demurrer, and not the prerogative of this court."); Arcady Farms Milling Co. v. Northcutt, 87 F. Supp. 373 (E.D.S.C. 1949) ("It is my duty to study the record to be sure that federal jurisdiction exists before determining the motion [to dismiss for failure to state a claim] of these defendants."); Johnson v. Marsh, 49 F. Supp. 137 (D. Neb. 1943) ("This is not the time, nor, unless and until jurisdiction is retained, is this the place for the consideration of infirmities in the pleading of the plaintiffs, or even whether it adequately states a cause of action under the state law, or under the federal rules a claim upon which relief may be granted, against the removing defendant."); Hoge v. Fort Smith Gas Co., 37 F. Supp. 71

(D.C.W.D. Ark. 1941) ("While it is the duty of the federal court to hear the evidence on the question of fraudulent joinder [for purposes of deciding remand], it is not the duty of the court to go into the merits of the case."); *Metcalf v. Bardo Coal Co.*, 28 F. Supp. 1 (D.C.E.D. Kentucky 1939) ("The merits of plaintiffs' claims in law or in fact are not here open for consideration. The challenged right of removal calls only for a [jurisdictional] appraisal of the case as declared upon the pleadings."); *Maruska v. Equitable Life Assurance Society*, 21 F. Supp. 841 (D.C.D. Minn. 1938) ("The court cannot, in disposing of a motion to remand, permit itself to be swayed by its opinion as to the real merits of the suit."); *Forrest v. Southern Ry. Co.*, 20 F. Supp. 852 (D.C.W.D. S.C. 1937) ("'This court may not pass upon the sufficiency of the allegations as upon demurrer since we are limited solely to the question of jurisdiction. If it should be held by the State Court that the allegations are not sufficient to sustain the charge of joint liability, it would be the prerogative of the State Court to dismiss upon demurrer and not the prerogative of this court.'").

Among the more often cited district court opinions on the issue of remand versus dismissal is that in *Kerbow v. Kerbow*, 421 F. Supp. 1253 (D.C.N.D. Tex. 1976). The *Kerbow* case presented the district court with an action by two ex-wives against their ex-husbands and their ex-husbands' mutual corporate employer for recovery of employee benefits reserved for their ex-husbands by the corporate defendant but not shared with the ex-wives as part of their respective divorce settlements. *Id.*, at 1255-1257. The cases were originally filed in state court but the corporate defendant petitioned for removal to federal court where the corporate defendant then filed a motion to dismiss under Rule 12(b)(6) of the Federal Rules of Civil Procedure while the plaintiffs filed their respective motions to remand. *Id.*

In stating the law regarding the propriety of ruling on the defendant's motion to dismiss prior to ruling on the plaintiff's motion to remand, the Kerbow court incorporated the same language from the Wright & Miller text which the State cited earlier, supra, in the present brief: "Once a motion to remand is filed, the federal district court is limited solely to the question of its authority to hear the case pursuant to the removal statute. . . Thus, the court must be certain that federal jurisdiction is proper before entertaining a motion by defendant to dismiss plaintiff's complaint for failure to state a claim upon which relief may be granted." Id., at 1258, citing 14A Wright & Miller § 3739, at pp. 757-758, 760, and 760 at n.14.

Yet, despite its recognition of the clear jurisdictional mandate which requires that a motion for remand be ruled on prior to probing the sufficiency of the original complaint, the district court in Kerbow nonetheless refused to remand those claims dealing with ERISA-covered benefits and instead granted the corporate defendant's 12(b)(6) motion as to those claims. Id., at 1260. In explaining this deviation from proper ruling practice, the Kerbow court noted that the corporate defendant had relied for its removal on the civil enforcement of ERISA, 29 U.S.C. 1132(e)(1). Id., at 1259.[2] "Unfortunately," the Kerbow court states, "29 U.S.C. 1132(e)(1) is one of those specific statutory grants of jurisdiction where questions of jurisdiction are hopelessly intertwined with questions of standing and failure to state a claim." Id. Relying on the specific statutory grant of subject matter jurisdiction to the federal courts in 29 U.S.C. 1132(e)(1), the Kerbow court was able to assume removal jurisdiction for the further purpose of ruling on the corporate defendant's motion to dismiss. Id., at 1259-1260. However, even despite its dismissal of the ERISA claims, the Kerbow court went out of its way, in the interests of federalism, to order a remand to state court of those remaining state law claims which were unrelated to ERISA and the specific statutory grant of jurisdiction in 29 U.S.C. 1132. Id., at 1260.

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[2] 29 U.S.C. 1132(e)(1) reads as follows:

> (1) Except for actions under subsection (a)(1)(B) of this section, the district courts of the United States shall have exclusive jurisdiction of civil actions under this subchapter brought by the Secretary or by a participant, beneficiary, or fiduciary. State courts of competent jurisdiction and district courts of the United States shall have concurrent jurisdiction of actions under subsection (a)(1)(B) of this section.

If this Court has begun to recognize, in the State's discussion of the Kerbow decision, an argument it has heard before, it is because 29 U.S.C. 1132(e)(1) is the same statutory section which was at issue in the Supreme Court's decision in Franchise Tax Board of the State of California v. Construction Laborers Vacation Trust for Southern California, 463 U.S. 1 (1983), an opinion which the State has already analyzed fully in its earlier brief on the inability of a preemption defense to provide the foundation for federal removal jurisdiction. See, Plaintiff's Response to Defendant's Memorandum in Opposition to Plaintiff's Second Motion for Remand, Sections I and II. In other words, the Kerbow decision, and the State's discussion of it, represent more than just another district court citation in the remand/dismissal litany. The significance of Kerbow to the present case is that the district court there, like the Southern District in the present case, faced both the remand/dismissal issue and the issue of whence the district court derived its removal jurisdiction in an area overshadowed by federal regulation. When presented with both issues at once, the Kerbow court was careful to not only point out that proper procedure normally required it to consider the plaintiff's remand arguments separately without entertaining the defendant's dismissal analysis, but the court was also careful also to be certain that, in an effort to "scrupulously limit" its removal jurisdiction, the district court could discover its otherwise narrow removal jurisdiction in a specific statutory grant of federal jurisdiction over the particular subject matter of the action. Of course, as the State has already pointed out in its earlier briefs, the Southern District has been given no such statutory authority in the Cable Communications Policy Act of 1984. Id.

Thus, Kerbow should provide the cognitive bridge, in the present case, between this Court's remand/dismissal analysis and its decision of whether removal jurisdiction exists at all on the face of the State's complaint. Such a connection should finally serve to point out the procedural confusion and jurisdictional absurdity which can result from the ministerial application of a time frame order to a case, like the present one, which still remains in the jurisdictional limbo created by a pending motion for remand.

## III.

## THE COURT LACKS ANY BASIS FOR EXERCISING ITS REMOVAL JURISDICTION OVER THE PRESENT CASE AND THEREFORE SHOULD REMAND THE ACTION TO STATE COURT WITHOUT RULING ON DEFENDANT'S MOTION TO DISMISS.

The State of West Virginia will not expend the limited resources of its taxpaying citizens to once again, and for the third time, detail the full scope of the law and argument which establish that this Court has no jurisdiction to remove the present case, especially when such jurisdiction appears to be predicated solely on the speculative and spurious federal preemption defense argument previously asserted by the defendant. See, id., and Plaintiff's Memorandum in Support of Plaintiff's Second Motion for Remand. However, in the interest of absolute thoroughness, the State believes a return to a fundamental statutory analysis of federal removal jurisdiction may at last produce a ruling on the pending motion for remand.

Since a preemption defense provides no basis for removal under 28 U.S.C. 1441, this Court must discover some other foundation in that statute for its removal jurisdiction before the Court may proceed to a substantive analysis of the case through consideration of a motion to dismiss. See, Section II, supra; see also, United States Constitution Article III, section 1; Ex parte McCardle, 74 U.S. 506 (1869). Since the right to remove a case from a state to a federal court is purely statutory, that alternative foundation will be found, if at all, in the specific and limited legislative grants of jurisdiction to the federal district courts. Martin v. Hunter's Lessee, 1 Wheat. (14 U.S.) 304, 349 (1816).

The first consideration under the removal statute is whether the Southern District has original jurisdiction over the present case, as founded on a claim or right arising under the Constitution, laws or treaties of the United States. 28 U.S.C. 1441(a). Even the most cursory review of the State's complaint in this case will bear out that it consists solely of state law claims which arise under state law and do not arise under, nor implicate the Constitution, laws, or treaties of the United States as an essential element of any of the complaint's causes of action. 28 U.S.C. 1441(a); Phillips Petroleum Vo. v. Texaco, Inc., 415

U.S. 125 (1974). Again, the State has already fully addressed this question in the briefs previously filed in this case. However, since the tests under 28 U.S.C. 1441(a) (removal jurisdiction) and 28 U.S.C. 1331 (federal question jurisdiction) are precisely the same, a straightforward legal analogy should serve to lay to rest any notion of this Court's federal question removal jurisdiction by widening the benefit of doubt in favor of the defendant.

To shift this benefit to defendant, one might hypothesize that the State originally filed the present case, with the same claims, in the Southern District. This sufficiency test of the State's complaint, unlike the now defunct derivative jurisdiction rule, strips away the complex case law which surrounds 1441(a), and instead analyzes the pure federal question elements present in the State's claims. This is possible since the rudimentary test of federal jurisdiction, whether under § 1441 or § 1331, is the same--does the face of plaintiff's "well pleaded complaint" identify a federal question.

The "well pleaded complaint" rule emerged to aid in the interpretation of the "arising under" limitation in Article III, section 2 of the United States Constitution, and later in 1441(b) as a statutory embodiment of that limit. *Osborn v. Bank of United States*, 9 Wheat. 738, 6 L. Ed. 204 (1824); *Phillips Petroleum Co. v. Texaco Inc.*, 415 U.S. 125, 94 U.S. 1002, 39 L. Ed. 2d 209 (1974); *Pan American Petroleum Corp. v. Superior Court*, 366 U.S. 656, 81 S. Ct. 1303, 6 L. Ed. 2d 584 (1961). Of course, as a general matter, "[a] suit arises under the law that creates the cause of action." *American Well Works Co. v. Layne & Bowler Co.*, 241 U.S. 257, 260, 36 S. Ct. 585, 586, 60 L. Ed. 987 (1916). However, when *state* law "creates the cause of action," the well pleaded complaint rule's face-of-the-complaint test serves as a severe limit on the federal court's jurisdiction. Franchise Tax Board of the State of California v. Construction Laborers Vacation Trust for Southern California, 463 U.S. 1, 10-11, 103 S. Ct. 2840, 2846, 77 L. Ed. 2d 420 (1983).

The State of West Virginia's complaint in the present case, which on its face only alleges violations of state antitrust and consumer protection statutes, offers no federal question "hook" on which the Southern District can hang its jurisdiction: Count I of the State's complaint pleads a violation of W. Va. Code 46A-6-104, alleging "unfair and deceptive trade practices" by defendant in its attempts to force consumers to buy a product they did not want; Count II pleads violations of W. Va. Code 46A-6-102(f)(12), (13), and (14), alleging "unfair and deceptive trade practices" by defendant in its use of misleading advertising to encourage consumers to accept a new product; Count III pleads violations of W. Va. Code 46A-6-102(f)(5), (11), (12), (13), and (14), alleging "unfair and deceptive trade practices" by defendant when it claimed that certain converter boxes were "free" when in fact defendant intended to recoup the cost of such boxes through hidden pricing; Count IV pleads a violation of W. Va. Code 47-18-3(a), alleging the past and continued tying of defendant's premium and basic programming products; Count V of the State's complaint pleads a violation of W. Va. Code 47-18-3(a), alleging the past and continued tying of defendant's tier and basic programming products; Count VI of the State's complaint pleads a violation of W. Va. Code 46A-6-104, alleging "unfair and deceptive trade practices: by defendant in conditioning the sales of various of its programming services on the purchase of other of its products; and, Count VII pleads a violation of W. Va. Code 47-18-4, alleging the use by defendant's market power to control the market for its product.

After the microscopic observation given, supra, to the plain language of the State's complaint, the Southern District would be hard pressed to find a federal question which would permit it to assume jurisdiction, even under § 1331 standards. None of the violations pleaded by the State even comes close to "arising under" the Constitution, laws or treaties of the United States. Moreover, there are no amorphous sections of the complaint, or sections which plead a state common law remedy, either of which might be the subject of speculation as to federal subject matter jurisdiction. Rather, each count of the State's complaint attaches itself firmly to the specific language and citation of West Virginia statute.

Just as the Southern District cannot discover its removal jurisdiction from the face of the State's complaint, even when employing a § 1331 analysis, the Court will also find no alternative source of that jurisdiction from the remaining statutory grants in 28 U.S.C. 1441. Defendant has already conceded that 28 U.S.C. 1441(b), the statute allowing removal jurisdiction based on diversity, does not apply to the present case. Memorandum of American Television and Communications in Opposition to the Motion to Remand, at p. 2. Nor will the Court be able to base its removal jurisdiction over the present case on a pendent or ancillary jurisdictional analysis under 1441(c) since, as detailed supra, the State's complaint provides no "separate and independent claim or cause of action which would be removable if sued upon alone" (i.e., an "arising under" question). The only other recourse under the removal jurisdiction statute, section (d) of 1441, is not available to defendant since defendant is not a foreign state. Of course, the present case does not involve a federal officer (28 U.S.C. 1442), a member of the United States armed forces (28 U.S.C. 1442(a)), a federal civil rights action (28 U.S.C. 1443), or a foreclosure action against the United States (28 U.S.C. 1444).

With no adequate explanation based on the language of the removal statute, and with a preemption defense unable to serve as the basis for removal, this Court's apparent exercise of removal jurisdiction over the present case seems clearly in error. This legal conclusion was long ago argued for this Court by the State, and herein the State's analysis has served to further and, hopefully, exhaust all discussion of the subject. However, the continued delay by the Court in addressing the State's ongoing jurisdictional contention has produced, in combination with the filing of a court-required motion to dismiss, more than simple inconvenience, impatience and expense--it now threatens to warp the precise jurisdictional boundaries established for a judicial system based on federalism.

The dictates of stare decisis have produced, supra, a legal critique of the Court's present action in abstaining from issuing a remand ruling until the time for a dismissal decision. However, since such protraction at the remand stage is more the aberration than the rule, a brief equitable account of the dangers, both constitutional and otherwise, inherent in the present hybrid procedure should assist in persuading this Court to rule on the remand issue without concurrently reaching defendant's dismissal motion.

The State of West Virginia believes the central negative ramification implicit in this Court's temporization on the remand ruling will be to send future corporate defendants in the State of West Virginia, who are looking for an opportunity to stall and frustrate state enforcement authorities, a clear, two-part message. The first part of the message states, "whenever faced with antitrust or consumer protection suits under West Virginia law, which suits allege violations in an area regulated to any degree by federal statutes or rules, remove such cases under a claim of a federal preemption defense." The second part of the message sent to defendants reads, "and if you remove, you will have the opportunity to view the State's case during an attendant consideration of the merits of the State's complaint through a 12(b)(6) motion." In short, despite the clear case law denying the use of a preemption defense as a basis for removal and the case law which stands against the joint consideration of remand and dismissal, defendants will come to understand that setting up such a defense, and participating in a conjoint remand/dismissal procedure, can buy them twelve months on the Southern District's docket.

The publication of such messages is not dangerous because of the expense and frustration it places on the State of West Virginia in its attempts to enforce its own sovereign laws. Rather, the danger of a timid approach to the question of remand will be to undermine the basic precepts of the federal system. If the federal courts begin to implicitly expand their constitutionally limited jurisdiction through the creation of remand-related procedural tangles, then the antitrust and consumer protection laws of West Virginia, and every other state, will become watered down versions of the strong enforcement structures dictated by the state legislatures. Such state laws will come to be dead letters, undercut by stall and obfuscation in the guise of the removal petition. Moreover, the proverbial floodgates protecting federal jurisdiction will be opened wide to every state complaint which theoretically impinges on an area regulated by the federal government.

Proof of removal jurisdiction then, should constitute a threshold through which each complaint must pass before entering within the procedural and substantive boundaries of the federal courts. Congress, in passing 28 U.S.C. 1441, never intended to spawn a separate species of federal case which would carry with it the label of "pending removal." Yet, the Southern District, through its actions in the present case, proposes to create just such a species. In the future, state defendants will come to believe that there is a reservoir set aside in this Court's docket for cases presenting a preemption defense basis for removal, and that those cases will be carried along until they are conveniently complicated by the initiation of substantive proceedings.

Whether or not this Court is prepared to disregard a century of United States Supreme Court precedent on the scope of removal jurisdiction, and whether or not this Court is ready to bypass the district and circuit court precedent which refuse to allow consideration of the dismissal question prior to a remand ruling, this Court must still at least illuminate those alternative statutes or precedents which provide the basis for its federal question jurisdiction before asking the State of West Virginia to consent to a potentially mistaken consideration of defendant's motion to dismiss. After all, the State of West Virginia is not relieved, by the application of a time frame order, from its duty to the people of West Virginia to defend their sovereign control over the enforcement and interpretation of the their laws. That defense, in the present case, necessarily takes the form of the State's insistence on the establishment by this Court of its removal jurisdiction prior to its entertaining motions or argument under Rule 12 of the Federal Rules of Civil Procedure. Once that jurisdiction has been legitimately established, the people of West Virginia will be adequately assured that their sovereign rights are not being usurped by an improper assumption of federal power. Only at that juncture will the State of West Virginia be at liberty to begin considering the substance of defendant's 12(b)(6) arguments.[3]

## IV.

## CONCLUSION

FOR THE REASONS STATED ABOVE, the State requests that this Court forbear consideration of any motions or arguments for dismissal presently pending before the Court under Rule 12(b) of the Federal Rules of Civil Procedure, and instead that the Court grant the State's pending motion for remand.

IN THE ALTERNATIVE, if the State's motion for remand denied, the State requests that any order incorporating su denial be crafted to meet the requirements of 28 U.S.C. 1292(b) and that proceedings on the present case in the Southern District, including those related to defendant's pending motion for dismissal under Rule 12(b)(6), be stayed pending appellate review pursuant to a denial order so crafted.

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[3] The State certainly comprehends defendant's 12(b)(6) arguments, and the State feels confident that it can rebut the same. However, the State will not delineate these arguments other than in a forum where subject matter jurisdiction has been definitively established.

STATE OF WEST VIRGINIA ex rel.
CHARLES G. BROWN, Attorney General,
Plaintiff,

By Counsel

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# CERTIFICATE OF SERVICE

I, Mark D. Kindt, Deputy Attorney General for the State of West Virginia and counsel for plaintiff, do hereby certify that a true copy of the foregoing Plaintiff's Response to Defendant's Motion to Dismiss was served upon Larry Winter, Esquire, counsel for defendant, by hand delivering said copy to him at the offices of Spilman, Thomas, Battle & Klostermeyer, 500 Virginia Street, Charleston, West Virginia, on the 8th day of January, 1988.

Mark D. Kindt

Mark D. Kindt

ATTORNEY GENERAL
CHARLIE BROWN

EXHIBIT Q

March 15, 1988
Contact: Marc Dann
304/343-8800

## Statement
## by
## West Virginia Attorney General Charles G. Brown

Today, West Virginia Attorney General Charles G. Brown announced he is forming a multistate antitrust task force to investigate anticompetitive practices in the market for satellite delivered programming. General Brown made the announcement in Washington, D. C. where he was attending meetings of the National Association of State Attorney Generals (NAAG) from the Association headquarters.

General Brown chairs the NAAG Antitrust Committee where he has been a leader in pursuing vigorous enforcement of antitrust law. The task force assembled by General Brown includes five states: West Virginia, Ohio, Texas, New York and Maryland.

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CHARLESTON, WV [illegible]

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General Brown hosted a workshop meeting in the United States Capitol Monday night, March 14. The meeting was attended by Attorney Generals and staff from several states as well as key Congressional staff involved in upcoming cable television hearings.

"The workshop provided an opportunity for us to discuss whether there is adequate competition among cable, wireless cable, and other retail distributors of satellite-delivered programming," General Brown said.

General Brown commended Senator Howard Metzenbaum (D-OH) for holding antitrust hearings on this subject in Washington, D. C. on March 17, 1988. He also noted the leadership Senator John Kerry (D-MA) has exercised in investigating anticompetitive practices in the industry, such as recent wireline exclusivity proposals by programmers affiliated with big cable interests.

Last year, General Brown brought an antitrust action against a local cable television company operating in the State Capitol of Charleston. In the future, General Brown plans to develop an effective state-level strategy through his multistate task force and work closely with Congress as it addresses problems with the cable television industry.

## NATIONAL ASSOCIATION OF ATTORNEY GENERALS ("NAAG")
## Wireless Cable "Working Group" of Antitrust Multistate Task Force

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HEADLINE: HBO Withdraws Exclusivity;
NATIONAL ATTORNEYS GEN. ANTITRUST COMMITTEE STARTS CABLE PROBE

BODY:

Allegations of anticompetitive practices by cable will be investigated by new working group created by W.Va. Attorney Gen. Charles Brown, chmn. of Antitrust Committee of National Assn. of Attorneys Gen. (NAAG). Brown said at news conference at NAAG Washington hq Tues. that cable is unregulated monopoly restricting access by would-be competitors to satellite-delivered programming. As result of lack of competition, he said, cable has instituted "outrageous" price increases and retiered its program offerings at will.

Multichannel multipoint distribution service (MMDS) and cable integration issues will be addressed March 17 at hearing before Senate Antitrust Subcommittee, 9:30 a.m., Rm. 226, Dirksen Bldg. Added as witnesses (CD March 11 p8) are NCTA Pres. James Mooney, N.Y. Cable Commission Chmn. William Finneran, Home Satellite TV Assn. spokesman George Kocian. List includes 2 representatives of MMDS businesses -- Microband Pres. Mark Foster and Cleveland MMDS system Pres. James Theroux. Witnesses will be divided into 4 panels.

Brown said NAAG Cable Antitrust working group includes attorneys gen. from Md., N.Y., Ohio, Tex., W.Va. Group held work session March 14 with staff representing Antitrust Subcommittee members Chmn. Metzenbaum and Glenn (both D-O.), and Sens. Byrd and Rockefeller (both D-W.Va.), Kerry and Kennedy (both D-Mass.), Hollings (D-S.C.), Dodd (D-Conn.), Pressler (R-S.D.).

NCTA said that FCC has examined scrambled satellite-delivered program market "extensively" and found it developing competitively. Assn. also said that Justice Dept. has conducted similar inquiry and "thus far appears not to have found reason for concern. We have no reason to believe that any further investigations will turn out differently."

Brown said he was concerned particularly that so-called wireless cable, or MMDS, is being frozen out of access to programming through cable vertical integration. He said working group was formed in part to fill gap left by what he described as lack of action by DoJ in examining vertical integration for antitrust. He said his group is collecting data that could lead to: (1) Private litigation. (2) DoJ or FTC action. (3) Congressional review of 1984 Cable Act. (4) Legal action brought by state.

Factor that Brown repeated as pivotal to his starting probe was series of complaints he received in W.Va. when prices "practically doubled" after cable rate setting was deregulated in Jan. 1987. He said related issue was cable retiering last year. He criticized NCTA study of rate increases last year (CD Nov 24 p4) as "nothing more than a PR document." NCTA said its 1987 national study found cable bill rose 6.7% and basic rate 11%. W.Va. is conducting its own rate survey, according to W.Va. Deputy Attorney Gen.-Antitrust, Mark Kindt.

What Brown hopes to derive from multistate working group is cooperative effort in which states may examine national issues. He listed as examples recent cases involving Chrysler's rolling back odometers on cars and Minolta's overcharging for its cameras. In both instances, several states pursued legal cases that resulted in benefits to all states, he said. Brown has been active in W.Va. , recently won ruling in U.S. Dist. Court case against ATC affiliate challenging whether federal Cable Act preempts state antitrust and consumer protection laws. Federal judge remanded case to state courts.

Meanwhile, HBO announced Tues. it was in process of withdrawing its overbuild protection plan "based on lack of signed commitments." Only about 2 dozen small cable operators -- and no big MSOs -- had signed agreements to participate, spokesman said. "We don't have anywhere near the commitments we need to make it work," he said. In order to have exclusive franchise cable rights for HBO or Cinemax, MSOs would have had to pay 25 cents per subscriber in all its systems and agree to do more marketing of services, and they couldn't have deal for exclusivity with Showtime/Movie Channel or American Movie Classics/Bravo.

Reasons for lack of MSO participation "were across the board," HBO spokesman said. MSO officials had told us they thought plan was too expensive and too restrictive (CD Feb 19 p6). HBO spokesman said company found "interest in concept" and may introduce another plan in future.

EXHIBIT R

**CENTRAL TELECOMMUNICATIONS, INC., Appellee,**

**v.**

**TCI CABLEVISION, INC., Community Telecommunications, Inc. and Telecommunications, Inc., Appellants.**

No. 85-1805.

United States Court of Appeals,
Eighth Circuit.

Submitted March 10, 1986.

Decided Aug. 26, 1986.

Rehearing and Rehearing En Banc
Denied Oct. 16, 1986.

Unsuccessful applicant for city's exclusive cable television franchise brought suit against incumbent franchisee asserting antitrust claims and pendent state law claim for tortious interference with business expectancy. The United States District Court for the Western District of Missouri, Scott O. Wright, Chief Judge, 610 F.Supp. 891, entered judgment on jury verdict for applicant and incumbent appealed. The Court of Appeals, Heaney, Circuit Judge, held that: (1) city could properly offer de facto exclusive franchise in order to create competition for its cable television market; (2) jury instruction describing extent of *Noerr-Pennington* doctrine was proper; (3) finding that incumbent's coercive tactics went beyond mere lobbying was sufficiently supported by evidence; (4) incumbent had monopoly power; (5) applicant made sufficient preparations to enter cable television business to recover antitrust injuries to business; and (6) applicant could recover under Missouri's tortious interference law.

Affirmed.

**1. Monopolies 🔑12(6)**

Even if cable television company had First Amendment right to remain in city's cable television market with or without franchise from city, company was not insulated from antitrust liability to competitor who failed in bid to obtain exclusive franchise, where company did not seek to simply remain in market but rather sought to continue its monopoly. U.S.C.A. Const. Amend. 1.

**2. Monopolies 🔑12(6)**

"Natural monopoly" characteristics of city cable television market justified city in offering de facto exclusive franchise in order to create competition for cable television market and thus unsuccessful bidder for franchise had protectable interest under federal antitrust law. Sherman Anti-Trust Act, §§ 1, 2, 15 U.S.C.A. §§ 1, 2.

**3. Monopolies 🔑12(16.5)**

Jury instruction, that *Noerr-Pennington* doctrine protects all "genuine" lobbying efforts but does not protect "threats, intimidation, coercion, or other unlawful acts" which were "not genuine efforts to influence public officials," was proper in action against cable television company seeking to retain its exclusive city franchise.

**4. Monopolies 🔑28(7.4)**

Finding that incumbent holder of cable television holder of cable television franchise had exceeded balance of legitimate lobbying activity in seeking renewal of its franchise, and thus was not protected by *Noerr-Pennington* doctrine, was sufficiently supported by evidence of incumbent's heavy handed and coercive tactics against city officials.

**5. Federal Civil Procedure 🔑1970**

Court's allowance of 90 minutes per side for closing arguments was not abuse of discretion in antitrust action concluded after 31 days of trial.

**6. Monopolies 🔑12(6)**

Incumbent holder of exclusive city cable television franchise possessed monopoly power, despite fact market was regulated, where it had the power to raise price of "premium" channels without approval of city and used its entrenched position and various unethical or illegal practices to exclude competition in bidding for new exclusive contract.

**7. Monopolies 🔑28(7.4)**

Finding of conspiracy between incumbent holder of city's exclusive cable television franchise and city officials, in awarding renewal contract to incumbent was sufficiently supported by evidence that incumbent coerced and pressured city officials into anticompetitive position.

**8. Monopolies 🔑12(1.6)**

Bidder for city's exclusive cable television franchise made sufficient preparations to enter cable television business to recover for injury to "business", under § 4 of Clayton Act, where bidder had secured financing commitments in excess of 2 million dollars, had submitted detailed feasible plans for cable system in city, and had secured vote of city council for operating franchise. Clayton Act, § 4, 15 U.S.C.A. § 15.

**9. Torts 🔑10(3)**

Debtor for city's exclusive cable television franchise sufficiently proved it suffered damage to protectable interest, under Missouri's law of tortious interference with business expectancy, where damage award was based on best evidence available and estimate of loss was reasonable.

**10. Monopolies 🔑28(9)**

Award of 10.8 million dollars to precluded bidder for city's exclusive cable television franchise was sufficiently supported by precluded bidder's uncontradicted evidence of fair-market value of franchise.

**11. Damages 🔑94**

Award of $25 million dollars in punitive damages on tortious interference claim of precluded bidder for city's exclusive cable television franchise was sufficiently supported by substantial evidence of incumbent cable company's intentional tortious conduct in preventing award of franchise to bidder.

Stuart W. Gold, New York City, for appellants.

R. Lawrence Ward, Kansas City, Mo., for appellee.

Before HEANEY and FAGG, Circuit Judges, and WOODS,* District Judge.

HEANEY, Circuit Judge.

This antitrust-monopolization case arises out of competition between TCI, Cablevision, Inc. (and two related corporations, collectively TCI) and Central Telecommunications, Inc. (Central), for a defacto [1] exclusive cable television franchise in Jefferson City, Missouri (the City).

## I. FACTS.

TCI managed the City's cable television system for the Athena Cablevision Corporation from 1973 to 1978. In 1978, it acquired the assets of Athena in the City and was then awarded a three-year exclusive cable television franchise. Three months before TCI's franchise was scheduled to expire, the City initiated a "Request for Proposals" (RFP), or bidding process, to solicit bids to determine the recipient of the next franchise.

Two companies—Central and Teltran—submitted bids for the franchise.[2] TCI refused to participate, arguing that it had a first amendment right to continue to provide cable television services in the City, and that the City thus had no right to award an exclusive franchise to another company. The City contended that its cable television market was a "natural monopoly" and that it could not create competition for its cable TV market without offering an exclusive franchise.

TCI then began a campaign, accompanied by numerous unethical and illegal acts, to coerce the City to grant it the exclusive franchise. Nonetheless, after a preliminary vote in January of 1982 in favor of Central, the City Council voted in April, 1982, to grant the exclusive franchise to Central. Central was obligated under this franchise to provide substantially expanded services to subscribers at a cost less than they had been paying. The mayor immediately vetoed this ordinance and the City Council was unable to override it. An ordinance was promptly submitted which proposed renewal of TCI's franchise. The Council deadlocked at a five-to-five vote and the mayor then cast the tie-breaking vote in favor of TCI. The TCI proposal provided fewer viewing channels and inferior picture quality at a higher monthly rate than did the Central proposal.

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* The Honorable HENRY WOODS, United States District Judge for the Eastern District of Arkansas, sitting by designation.

[1] Although the franchises at issue in this case were nominally termed "nonexclusive," they were, in practical operation, exclusive. Accordingly, we generally term the de facto exclusive franchises simply "exclusive."

[2] TCI ultimately also submitted an application, but the City determined that the application could not be considered because it failed to comply with the RFP.

Central then brought this action against TCI, alleging that TCI had unlawfully interfered with the RFP process to deny Central the franchise and to retain an exclusive franchise for itself. After thirty-one days of trial, the court granted Central's motion for a directed verdict on TCI's counterclaims, and submitted the case to the jury on three theories: 1) that TCI had unlawfully conspired with the mayor and other City officials to retain its exclusive franchise in violation of Section One of the Sherman Antitrust Act; 2) that TCI had undertaken illegal anti-competitive actions to retain its monopoly of the Jefferson City cable TV market in violation of Section Two of the Sherman Antitrust Act; and 3) that TCI had tortiously interfered with Central's business expectancy in violation of the laws of the State of Missouri. The jury ruled in favor of Central on all three claims and awarded $10,800,000 in actual damages on its antitrust and state law claims and $25,000,000 in punitive damages on the state law claim. The court trebled the $10,800,000 award, and entered judgment for $32,400,000 on the antitrust claims and, in the alternative, $35,800,000 on the state law claim. TCI appeals, raising seven issues, each of which we deal with in turn.

## II. DISCUSSION.

### A. First Amendment Challenge to Exclusive Franchising Scheme.

[1] TCI's first contention is that it has a first amendment right to remain in the City's cable television market with or without a franchise from the City, and that, therefore, Central could not have been damaged when it lost the exclusive franchise. We reject this argument. Before reaching the merits of this argument, we note that there is a significant factual problem with it. The district court found:

> Defendants enjoyed every opportunity to produce evidence and make arguments to persuade the jury that they were at all times in favor of head-to-head competition in the market place. * * * [However] the jury [was not] swayed by any of these arguments [and] factual findings implicit in [its] verdict confirm that TCI's endorsement of head-to-head competition lacked sincerity. * * * There was substantial evidence that defendants were engaged in a calculated scheme to prevent plaintiff from entering the Jefferson City market and to maintain a *de facto* exclusive franchise for themselves. * * * The jury's conclusion that defendants * * * were responsible for plaintiff's exclusion from the Jefferson City market * * * completely undermines any attempt to pass the blame on to the city by way of an amorphous "First Amendment defense."

*Central Telecommunications, Inc. v. TCI Cablevision, Inc.*, 610 F.Supp. 891, 903 (W.D.Mo.1985).

Because we find substantial evidence in the over 7,000-page record in support of this conclusion by trial judge and jury, we think that TCI's first amendment defense fails on its facts because it did not seek to simply remain in the market but to continue its monopoly.[3]

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[3] Under the Supreme Court's decision in *Associated Press v. United States*, 326 U.S. 1, 19–20, 65 S.Ct. 1416, 1424, 89 L.Ed. 2013 (1945), a member of the communications industry who conspires or engages in predatory conduct for the

Assuming arguendo that TCI was willing to compete head-to-head with any competitor, we find TCI's first amendment defense to be without legal merit. The district court held:

> [T]he grant of a single cable franchise is permissible only if the physical and economic conditions of the relevant market give rise to a "natural monopoly" situation. The theory is that, where physical and economic factors render a market incapable of accommodating more than one cable television system, the local governing body is in the best position to determine which proposed system offers the best service to the public for the lowest cost. Since only one competitor can survive in the market, it makes sense to allow the local government to choose the best[4] applicant.

*Central Telecommunications*, 610 F.Supp. at 899–900 (footnotes omitted), *citing Tele-Communications of Key West, Inc. v. United States*, 757 F.2d 1330, 1338 (D.C.Cir.1985); *Omega Satellite Products Co. v. City of Indianapolis*, 694 F.2d 119, 127 (7th Cir.1982); and *Community Communications, Inc. v. City of Boulder*, 660 F.2d 1370, 1378–80 (10th Cir.1981), *cert. dismissed*, 456 U.S. 1001, 102 S.Ct. 2287, 73 L.Ed.2d 1296 (1982).

The Supreme Court has not directly addressed this issue. In *Miami Herald Publishing Co. v. Tornillo*, 418 U.S. 241, 94 S.Ct. 2831, 41 L.Ed.2d 730 (1974), it rejected an argument that the natural monopoly characteristics of the newspaper market gave rise to a duty to provide public access to the press. However, it has approved "far more intrusive regulation of broadcasters than of other media [such as newspapers] * * * because of the inescapable physical limitations on the number of voices that can simultaneously be carried over the electromagnetic spectrum." *Quincy Cable T.V., Inc. v. F.C.C.*, 768 F.2d 1434, 1448 (D.C.Cir.1985), *citing, e.g., FCC v. League of Women Voters of California*, 468 U.S. 364, 104 S.Ct. 3106, 82 L.Ed.2d 278 (1984). Thus, the question is whether cable television should be analyzed under the standards applicable to newspapers or those applicable to broadcasters.

TCI contends that cable television is entitled to "coextensive protection" with the press media. In its recent decision in *Los Angeles v. Preferred Communications, Inc.*, — U.S. —, 106 S.Ct. 2034, 90 L.Ed.2d 480 (1986), the Court suggested that the cable medium may be distinguishable from the newspaper medium and that more government regulation of the cable medium may be permissible because cable requires use of public ways and installation of cable systems may disrupt public order. There, a cable television company sued the City of Los Angeles and its cable franchising department, alleging that the City violated its first amendment rights by refusing to grant it a cable television franchise or to allow it access to cable facilities on the ground that it had failed to participate in an auction for a de facto exclusive franchise in the area. The district court dismissed the complaint for failure to state a claim. The United States Court of Appeals for the Ninth Circuit then reversed and remanded for further findings on whether the City's exclusive franchising scheme violated the first amendment where there was economic and physical capacity for more than one franchise. It stressed that the City's only defense was that allowing more than one cable operator would overly burden and disrupt public property and order. The Supreme Court affirmed, "on a narrower ground than the one taken by [the Ninth Circuit]," 106 S.Ct. at 2036, and refused, without development of a more detailed factual record, to set forth the legal standard for assessing first amendment challenges to cable-franchising schemes. The Court simply held that, given that the Los Angeles cable market was not a natural monopoly and that the only alleged justification for limiting the num-

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purpose of eliminating its competitors is fully liable under the antitrust laws.

[4] We note that there is no question here of content regulation in determining who would be the "best" applicant.

er of cable operators in the Los Angeles rea entailed the use and disruption of ublic property and order, a remand was ecessary for determination of whether the etitioner's first amendment rights outveighed the disruptions alleged by the ity. Justice Blackmun, with whom Jusices Marshall and O'Conner joined, concuring, emphasized:

> I join the Court's opinion on the understanding that it leaves open the question of the proper standard for judging First Amendment challenges to a municipality's restriction of access to cable facilities. Different communications media are treated differently for First Amendment purposes. Compare, *e.g., Miami Herald Publishing Co. v. Tornillo*, 418 U.S. 241, 94 S.Ct. 2831, 41 L.Ed.2d 730 (1974), with *FCC v. League of Women Voters*, 468 U.S. 364, 381, 104 S.Ct. 3106, 3118, 82 L.Ed.2d 278 (1984). In assessing First Amendment claims concerning cable access, the Court must determine whether the characteristics of cable television make it sufficiently analogous to another medium to warrant application of an already existing standard or whether those characteristics require a new analysis. As this case arises out of a motion to dismiss, we lack factual information about the nature of cable television. Recognizing these considerations, *ante*, at 2037, the Court does not attempt to choose or justify any particular standard. It simply concludes that, in challenging Los Angeles' policy of exclusivity in cable franchising, respondent alleges a cognizable First Amendment claim.

106 S.Ct. at 2038–39.

The Tenth and Seventh Circuits have held that, on the facts before them, cable television is more analogous to broadcasting than to newspapers, and that a "natural monopoly" situation may justify an exclusive franchising scheme. In *Community Communications v. City of Boulder*, 660 F.2d 1370 (10th Cir.1981), Community Communications Corporation (CCC) had been operating an exclusive cable television system in certain neighborhoods of Boulder, Colorado, for many years. After several other companies expressed interest in operating cable TV franchises in other areas of the City, the City imposed a moratorium on CCC's expansion in order to provide other companies the opportunity to make bids to service the remaining parts of Boulder before CCC became so entrenched that new entry would be impracticable. CCC alleged that the moratorium violated the first amendment. The City contended that cable television is a natural monopoly and that if it was unable to grant de facto exclusive franchises for various neighborhoods, CCC would remain the only cable television operation in Boulder and its citizens would be denied access to diversity and state-of-the-art programing. The Court of Appeals reversed the district court's order enjoining the City from enforcing the ordinance, and ordered that all parties be frozen in their current circumstances until trial on the merits. The Court applied a balancing analysis, weighing the first amendment concerns against the asserted justifications for the exclusive franchise scheme and held that "natural monopoly is a constitutionally permissible justification for some degree of regulation of cable operators." 660 F.2d at 1379. The Court emphasized that the extent of regulation permissible is narrowly limited by, among other possible factors,

> differences in (1) the degree of natural monopoly or "scarcity" characterizing the medium, (2) the pace and potential for technological change, or (3) the uses and possible uses of the medium such as two-way cable communications or even interconnection, [which] might make kinds of regulations constitutionally permissible in one medium that would be forbidden in another. But we caution: the power to regulate is not one whit broader than the need that evokes it. [Footnote omitted.]

*Id.*

The next year, the United States Court of Appeals for the Seventh Circuit also found that where a relevant cable television market is a natural monopoly, an exclusive franchise may be permissible consistent with the first amendment. In *Omega Satellite Products v. City of Indianapolis*, 694 F.2d 119 (7th Cir.1982), the City of Indianapolis awarded two de facto exclusive cable television franchises for certain sections of the City. A third cable operator also serviced certain apartment complexes in the City. Because it operated simply by installing satellite dishes at the complexes, and thus did not use any public way, it was not subject to the City's franchising ordinance. This company then sought a franchise so it could interconnect apartment complexes without the need to install new satellite dishes at each complex. After the City failed to act on its application, the company connected two complexes with a cable through a drainage culvert. The City ordered the company to remove the cable and the company refused and sought an injunction, on Sherman Act and First Amendment grounds, forbidding the City from removing the cable or enforcing its franchising scheme. The district court denied the request for an injunction and the Court of Appeals affirmed, holding that on the First Amendment challenge, "If Chapter 8½ is invalid under the First Amendment (a question we emphatically do not decide) it is so because it lacks adequate standards and procedures, not because a city may not limit the entry of cable television companies." *Id.* at 129. It distinguished cable television from newspapers on the ground cable requires use of public ways and because television enjoys "universal access to the home * * * and [there is] a resulting felt need to protect children." *Id.* at 127–28. Accordingly, it stated that although natural monopoly is not a justification for exclusive franchising for newspapers, "The apparent natural monopoly characteristics of cable television provide * * * an argument for regulation of entry." *Id.* at 127–28. *See also Tele-Communications of Key West v. United States*, 757 F.2d 1330 (D.C.Cir.1985) (Holding that if cable company could show that there were no practical reasons why two cable operators could not serve Air Force base, Air Force's exclusive franchising scheme would violate the first amendment.) *But cf. Preferred Communications v. City of Los Angeles*, 754 F.2d 1396, 1404–05 (9th Cir.1985), *aff'd and remanded on other grounds*, — U.S. —, 106 S.Ct. 2034, 90 L.Ed.2d 480 (1986) (Although the Court did not reach the argument that natural monopoly justifies government regulation of cable television because it assumed that competition for cable services is economically feasible in the Los Angeles area, it implied that "natural monopoly" is not a justification for exclusive franchising.)

We recognize that there are profound first amendment implications inherent in the regulation of cable operators. Changes in technology such as were presented in the *Omega* case may require a different approach to exclusive franchising schemes. We are also aware of the difficulties inherent in the regulation of cable television programming. *See, e.g., Quincy Cable TV, Inc. v. FCC*, 768 F.2d 1434 (invalidating *FCC*'s "must carry" cable television regulations on first amendment grounds). *Cf. FCC v. Midwest Video Corp.*, 440 U.S. 689, 99 S.Ct. 1435, 59 L.Ed.2d 691 (1979) (invalidating as beyond F.C.C.'s jurisdiction rules requiring cable operators to make channels available for local access). Thus, we make clear, as did the Supreme Court in *Preferred Communications*, that we are unwilling to decide any question which is not squarely before us and on which there has not been a full development of the record. We are not faced here with a challenge to the details of Jefferson City's franchise regulations,[5] and we, of course,

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[5] Inherent in the City's authority to choose the "best" cable operator for the City is the issue of how the City may reach this conclusion. In this connection, we note that the RFP terms are directed toward providing the widest array of programing at the lowest cost and do not seek to prohibit the communication of any message. Thus, the RFP deals primarily with rates, quality and geographic breadth of service and states:

> The City is establishing few requirements as it desires that all applicants have maximum freedom to develop their own innovative proposals. * * * The City is interested in receiving proposals for a system with the capacity

consider the "natural monopoly" question only in terms of the competing technologies offered by TCI and Central. TCI's brief states the First Amendment issue to be: "Did plaintiff, which was seeking an exclusive cable television franchise that would deny others equal access to speak through the cable medium, have a protectable interest under federal antitrust or state tort law when it was not awarded the exclusive franchise?"

**[2]** We hold that Central did have a protectable interest because it proved, to the satisfaction of the jury and the trial judge, that the "natural monopoly" characteristics of the Jefferson City cable market justified the City in offering a de facto exclusive franchise in order to create competition for its cable television market. There is substantial support in the record for these factual findings.[6] TCI gained its monopoly through an earlier grant of a de facto exclusive franchise. Unless the City opened up competition *for* the market, TCI would have remained entrenched in its monopoly position. TCI refused to provide other than an outmoded limited channel system whereas Central proposed a state-of-the-art system with far more channels at a lower cost, and, accordingly, more variety of programming for the public. It is difficult for us to see how, on this record, TCI's position enhances First Amendment values. It is true that TCI has a First Amendment interest in remaining as a cable television "speaker," but Central has a similar interest. Because the evidence shows that given the technology offered by the competing companies, there was economic capacity for only one speaker, it seems clear that Central's proposal went further in advancing the First Amendment interests of the viewing public in the greatest variety of programming obtainable.

In sum, we reject TCI's First Amendment challenge for two reasons. First, the evidence reveals that TCI was not sincere in advocating competition in the market but simply sought to retain a monopoly originally gained through the grant of a de facto exclusive franchise. Second, the evidence reveals that the City's cable television market is currently a natural monopoly which, under present technology, offers room for only one operator at a time. Thus, we hold that the City could properly offer a de facto exclusive franchise in order to create competition for its cable television market.

### B. Noerr-Pennington Defense.

TCI contends that all but two of its allegedly anticompetitive actions, the threats of its corporate vice president to the City's consultant and a similar threat to a competitor, are protected activity within the purview of the *Noerr-Pennington* doctrine. This doctrine, derived from the cases of *Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127, 81 S.Ct. 523, 5 L.Ed.2d 464 (1961); *United Mine Workers of America v. Pennington*, 381 U.S. 657, 85 S.Ct. 1585, 14 L.Ed.2d 626 (1965); and *California Motor Transport Co. v. Trucking Unlimited*, 404 U.S. 508, 92 S.Ct. 609, 30 L.Ed.2d 642 (1972), exempts from antitrust liability[7] activities

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of delivering at least 50 channels to subscribers and with * * * technical standards which exceed current FCC requirements. * * * The City is not interested in proposed capacity which will not be used or which will necessitate unreasonably high subscriber rates. The City is interested in a flexible system which can best accommodate the present and future needs of institutional users without unduly burdening the average subscriber.

[6] *See, e.g.*, plaintiff's exhibit (PX) 400 (Touche Ross study); 19 T. 86 (Testimony of John Clair Smith, summarizing Touche Ross study: "The basic conclusion is that * * * a direct house-to-house competition between two cable companies would not be financially feasible in Jefferson City, that the market would not support sustained house-to-house competition.")

[7] The district court stated that "[a]lthough the *Noerr-Pennington* defense is most often asserted against antitrust claims, it is equally applicable to many types of claims which seek[ ] to assign liability on the basis of the defendant's exercise of its first amendment rights." *Central Telecommunications*, 610 F.Supp. at 896 n. 7. Although the United States Supreme Court has not directly confronted this issue, this Court has indicated that it agrees with the principle stated. *See, e.g., In Re IBP Confidential Business Documents Litigation*, 755 F.2d 1300, 1312 (8th Cir.

which are specifically designed to procure favorable governmental action, even when the underlying motivation and effect of the activities is anti-competitive. *See generally* 7 Von Kalinowski, Antitrust Laws and Trade Regulation, § 46.04 (1982).

In early 1980, the City considered holding out its cable franchise to competitive bidding. Shortly thereafter, TCI met with the mayor and attempted to persuade him to renew its franchise without a competitive bid process, so as to avoid a "frontal attack" by competitors. In December, 1980, the City issued its RFP, inviting any company, including TCI, to bid. Thereafter, the City hired Elmer Smalling as a cable television consultant to evaluate the various bids. TCI, upon learning that the City had hired Smalling, publicly attacked his qualifications in a defamatory manner.

On several occasions, from January of 1981 to the summer of 1981, Paul Alden, TCI's vice president and national director of franchising, telephoned Robert Brooks, chief operating officer of Teltran, a company which submitted a bid for the City's franchise, and threatened him that unless Teltran withdrew from the bidding process, TCI would make trouble for Teltran in Columbia, Missouri, where it operated a cable television franchise. Teltran subsequently dropped out of the bidding process on the ground there was a "distasteful environment" in Jefferson City.

In February, 1981, Alden and Harold Farrow, TCI's attorney, met with City officials and attempted to pressure them to abandon the RFP process and negotiate exclusively with TCI. In March of 1981, Alden called the mayor and threatened to turn the system off unless TCI's franchise was renewed. That same month, TCI filed a lawsuit against the City challenging the RFP process. During the litigation, TCI served on officials of the bank from which Central sought financing a subpoena seeking a very wide range of potentially confidential records. Central alleges that this was designed to destroy its financing.

In June of 1981, Alden approached Smalling and expressed TCI's displeasure with Smalling's participation in the RFP process. Alden threatened Smalling with statements like: "We know where you live, where your office is and who you owe money to. We are having your house watched and we are going to use this information to destroy you. You made a big mistake messing with T.C.I. We are the largest cable company around[.] We are going to see that you are ruined professionally." PX 83. Smalling understood these statements to be a threat to the lives of himself and his family. At this same time, Warner-Amex (another large cable company) was a client of Smalling's. Alden contacted Warner-Amex about Smalling. Following the threats, Smalling lost Warner-Amex as a client. Smalling told City Attorneys Christopher Graham and Thomas Utterback about Alden's threats. PX 83. On July 6, 1981, Utterback wrote the mayor and suggested that the RFP process be abandoned because some of the parties were interfering with the competitive bid process. PX 84. Utterback also expressed these concerns in a memorandum to the City Council in which he described TCI as a "relentless corporate bully." DX 17, T. 128.

In the fall of 1981, TCI met with Utterback and agreed to negotiate privately for renewal of its franchise, although this secret agreement and the subsequent private negotiations violated the RFP, which specified that all negotiations would be open,[8] as well as Missouri's "sunshine law." Mo.Rev.Stat. §§ 610.010-.030. After the City Council voted on January 25, 1982, to provisionally grant the franchise to Central, TCI refused to pay and withheld the prior year's franchise fees which were due and owing to the City in an amount exceeding $60,000. It had no basis for this withhold-

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1985). We reiterate our agreement with this position—which is not challenged on appeal—at least with respect to the tortious interference claim at issue.

[8] The RFP provides that "to insure that all negotiations will be open, no applicant shall contact any City Councilman or the Mayor outside the Council Chambers." PX 84A at 20(a).

ing other than an attempt to subvert the RFP process.

Throughout this period, TCI continued to publicly announce that it would cut off service if it was not awarded the franchise, and it announced that it would not sell "one bolt" of its system to whoever received the new franchise and that it would "rather have [its system] rot on the pole" than sell it to a competitor at any cost. Further, TCI's system manager in Jefferson City told elderly residents of a senior citizens' home that TCI would cut off service if denied a franchise, and the residents would be without television for two years pending construction of a new system because the concrete walls of their residence would not allow reception of over-the-air stations.

Additionally, TCI accompanied its franchise battle with misstatements of fact. For example, in one City Council meeting, Alden misrepresented to the council that TCI was the largest distributor of satellite dishes in the county, with an "exclusive" in Missouri, both "facts" he later admitted were untrue. TCI implied that only it could protect the City's cable system from destructive competition from satellite dishes. The district court also stated that an implication of this statement was that TCI would flood the City with satellite dishes unless it received the franchise. 610 F.Supp. at 895.

By April 5, 1982, the City reached an agreement to award the franchise to Central. At that point, the mayor, who had recused himself from the cable television issue for over a year due to an alleged conflict of interest, announced that he was reentering the cable television controversy, and he privately advised council members that he would veto any ordinance awarding a cable television franchise to Central. TCI and certain City officials, including the mayor, then met privately to negotiate a franchise for TCI. As part of the agreement, the mayor agreed to veto any award of a franchise to Central.

On April 20, 1982, the City Council passed the ordinance awarding a franchise to Central. The vote was six in favor and four against. The mayor vetoed the ordinance. The council then deadlocked five-to-five on awarding a franchise to TCI and the mayor cast the deciding vote in favor of that company.[9] The next day, TCI dismissed its lawsuit against the City and paid the withheld franchise fees.

TCI's initial argument is that even though its agent, Alden, may have made coercive threats to Smalling and Teltran, which are not protected under *Noerr-Pennington*, these threats did no harm to Cen-

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[9] The differences between Central's and TCI's proposals are outlined in PX 285. The Central proposal was superior in numerous respects. A few of the more significant advantages are summarized in the following chart:

COMPARISON OF CENTRAL TELECOMMUNICATIONS, INC., PROPOSAL
WITH REQUIREMENTS OF FRANCHISE ORDINANCES NO. 9777 and NO. 9778
[Awarding franchise to TCI]

| ITEM | CENTRAL TELECOMMUNICATIONS, INC. PROPOSAL | ORDINANCE No. 9777 & No. 9778 |
|---|---|---|
| ADDRESSABLE CONVERTERS | Provided to All Subscribers | Provided only to Subscribers Taking Expanded Service |
| EQUIPMENT FOR INTERACTIVE SERVICES | Head end Equipment Installed | None |
| SYSTEM DESIGN | Single Residential Cable<br>(42 Channels Downstream Capacity, 4 Channels Upstream Capacity) | Present System Expanded From 12 Channels to 21 Channels Downstream Capacity Within 12 months |
| | Single Institutional Network Cable | No Institutional Cable |
| | 2 Satellite Earth Stations | 1 Satellite Earth Station |
| SERVICES AND PROGRAMMING | Imported TV Stations—13 | Imported TV Stations—11 |
| | Pay TV Services—4 | Pay TV Services—2 |
| | FM Radio Service—23 Stations | FM Radio Service—<br>"In Excess of" 15 Stations |

tral and thus cannot serve as a basis for imposing liability. We disagree. The jury was given a proximate cause instruction and informed that it could only base liability on acts which were not genuine efforts to influence City officials. Giving Central the benefit of all reasonable inferences to be drawn from the record, the jury may have concluded that TCI's heavy-handed tactics frightened the mayor and some members of the City Council into awarding the franchise to TCI.

Additionally, TCI contends that even if Alden's threats harmed Central, the verdict must be set aside because we have no way of knowing whether the jury relied on these threats or on protected conduct in assessing liability against it. We reject this argument for several reasons:

First, the parties agreed to submit the case to the jury on a general verdict instruction and form, and there is evidence on the record as a whole to support the verdict. *Ybarra v. Burlington Northern, Inc.*, 689 F.2d 147, 150 (8th Cir.1982); *Bio-Rad Laboratories, Inc. v. Nicolet Instrument Corp.*, 739 F.2d 604, 607 (Fed.Cir. 1984), *cert. denied*, 469 U.S. 1038, 105 S.Ct. 516, 83 L.Ed.2d 405 (1985) ("In the absence of special interrogatories we presume the existence of factual findings and legal conclusions necessary to support the verdict reached by the jury.").

Second, TCI was under no obligation to continue to provide service to the residents of Jefferson City after its franchise expired, and it certainly had the right to inform City officials, its customers and the public at large of its intent not to do so. Likewise, TCI was under no obligation, except as required by the franchise agreement, to sell its cable television system to its successor, and it had a clear right to inform City officials, its customers and the public at large that it would not do so. *Cf. United States v. Otter Tail Power Co.*, 331 F.Supp. 54, 61 (D.Minn.1971), *aff'd*, 410 U.S. 366, 368, 93 S.Ct. 1022, 1025, 35 L.Ed.2d 359 (1973); *Aspen Highlands Skiing Corp. v. Aspen Skiing Co.*, 738 F.2d 1509 (10th Cir.1984), *aff'd on other grounds*, 472 U.S. 585, 105 S.Ct. 2847, 86 L.Ed.2d 467 (1985); *Hecht v. Pro-Football, Inc.*, 570 F.2d 982, 992 (D.C.Cir.1977), *cert. denied*, 436 U.S. 956, 98 S.Ct. 3069, 57 L.Ed.2d 1121 (1978).

Had TCI made a simple clear request that the jury be so instructed, it would have been error to refuse the request. But it appears from the record as a whole that TCI was not satisfied with this approach. It rather wanted and requested a broader instruction that would have immunized other conduct which the jury could well have found unlawful.[10] The district court refused to give TCI's overly broad, long and

COMPARISON OF CENTRAL TELECOMMUNICATIONS, INC., PROPOSAL

WITH REQUIREMENTS OF FRANCHISE ORDINANCES NO. 9777 and NO. 9778—Continued

[Awarding franchise to TCI]

| ITEM | CENTRAL TELECOMMUNICATIONS, INC. PROPOSAL | ORDINANCE No. 9777 & No. 9778 |
|---|---|---|
| INITIAL RATES | Basic TV Service: | Basic TV Service: |
| | Tier I (21 Channels)—$6.00/Month | Tier I (12 Channels) $6.55/Month |
| | Tier II (38 Channels)—$8.00/Month | Tier II (21 Channels) $8.55/Month |
| | Pay TV Service: | Pay TV Service: |
| | Home Box Office $7.95/Month | Home Box Office $9.95/Month |
| | Showtime $8.45/Month | Showtime $9.95/Month |
| | Cinemax $9.45/Month | — |
| | Movie Channel $7.95/Month | — |

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[10] TCI proposed the following *Noerr-Pennington* Instructions:

NOERR–PENNINGTON—GENERAL

The Constitution ensures the right of all persons and corporations, whether acting individually or in concert, to petition government for political action, recognizing that persons in the exercise of these constitutional rights naturally will petition government for political action that is favorable to their particular interests and unfavorable to the interests of others. The Supreme Court has declared that this right to petition government for political action is paramount, and that the concerted effort of various confusing *Noerr-Pennington* instructions, preferring more concise and understandable instructions and allowing TCI to argue at length before the jury that all of its activities were genuine lobbying efforts protected under *Noerr* and the threat to turn off service was lawful because TCI could not continue to provide service without a franchise. Under these circumstances, it is difficult to fault the district court judge for instructing the jury as it did and in permitting TCI to argue that it was simply exercising its first amendment rights when it engaged in the course of conduct that it did.

[3] Third, the trial court's jury instructions adequately informed the jury of the

parties genuinely to influence public officials does not in any way violate the law regardless of intent or purpose. Joint efforts truly intended to influence public officials to take official action do not violate antitrust laws even though the efforts are intended to eliminate competition.

Similarly, the Constitution protects a person's right of access to the courts for resolution of disputed issues. The antitrust laws are not violated when a person files a suit, even if he hopes and intends that the judge or jury will enter verdicts which will injure his competitors.

In short, activity which is intended to influence or cause official governmental action—whether by an individual such as a mayor, by a legislative body such as a City Council, or by judges and juries—does not violate the law, regardless of the intentions of the persons engaging in such activity.

NOERR-PENNINGTON—APPLICATION TO THIS CASE

To the extent that you find that defendants engaged in legitimate efforts to influence governmental action or to seek redress for its grievances through the courts, you are directed that you cannot find the defendants liable for any of the claims asserted by plaintiff based upon such activity. For example, if you were to find that all of defendants' actions about which plaintiff complains fit into this category of legitimate attempts to influence official action or to vindicate rights through the courts, then you could not find defendants liable for any of the offenses charged. That is, if you should conclude from a review of the evidence that defendants did nothing more in this case than take actions for the purpose of persuading the City to award them a cable television franchise on some basis, then you may not find that defendants committed any of the offenses charged, even if you believe that the purpose or necessary effect of such actions was to exclude plaintiff from obtaining a franchise. On the other hand, if you were to find that none of defendants' actions fit into that category, then you would simply assess those actions under the standards we have already discussed and without regard to this instruction. Finally, if you find that some of defendants' actions were legitimate attempts to influence governmental action but that some were not, then when you decide whether the evidence establishes that defendants committed any of the charged offenses, you must exclude from your consideration those actions which you find did in fact fall into that category, for they may not form the basis—in whole or in part—for any liability.

NOERR-PENNINGTON—EXCEPTIONS

However, the activity we are discussing must consist of genuine efforts to influence governmental action or to vindicate rights through the courts. Protection does not extend to purported petitioning that is a mere sham to cover what actually is nothing more than an attempt to interfere directly with the business of a competitor. That is, protection does not extend to activities that are merely a pretext for inflicting on plaintiff an injury not caused by any government action. Thus, you must consider whether defendants' activities were not really an attempt to influence an official to take official action, but instead were an attempt to interfere directly with the business of plaintiff. When deciding this question, you must consider the intent of defendants in taking such actions. If you find that their intent was to obtain some governmental action, no matter what the action was, then these activities were genuine. The success of defendants' efforts is evidence of their genuineness.

In the context of defendants' lawsuit against the City, about which you have heard some evidence, you must decide whether defendants filed the suit with the hope of obtaining a judicial ruling in their favor, or whether the suit was only intended to directly injure plaintiff in some manner. The extent to which a lawsuit involves legitimately disputed issues is circumstantial evidence of the genuineness of the suit. The knowledge that defense of the litigation might impose burdensome costs upon the City would *not* be sufficient to establish that defendants brought the suit in bad faith, in an attempt to injure plaintiff.

Finally, the Constitution does not protect attempts to influence governmental action by methods which are illegal in and of themselves; for example, by bribery of government officials. Such actions are not legitimate attempts to petition the government.

In sum, you must decide whether all or some of defendants' activities were legitimate and genuine efforts to obtain a franchise from the City. All such efforts must be excluded from your consideration of this case because they cannot—as a matter of law—form the basis of liability for any of the offenses charged.

*Noerr-Pennington* doctrine and that it could find that TCI's activities were protected activities within the parameters of this doctrine. Instruction Number 15 informed the jury that it could "not consider TCI's 1981 lawsuit against Jefferson City to have been unlawful conduct even if it was designed to eliminate competition." Instruction Number 14 informed the jury:

> In deciding whether defendants engaged in any unlawful conduct in this case, you are instructed that you may not consider defendant's legitimate lobbying efforts with the Jefferson City officials. The defendants are entitled under the law to use genuine efforts to influence public officials but if in fact defendant's lobbying activities included threats, intimidation, coercion or other unlawful acts, then you may find that such activities were not genuine efforts to influence public officials and you may consider those acts to have been unlawful conduct.

TCI contends that Instruction Number 14 allowed the jury to base its verdict on activities which were lawful under *Noerr-Pennington.* We reject this argument because we find that the instruction's statement that *Noerr-Pennington* protects all "genuine" lobbying efforts but does not protect "threats, intimidation, coercion, or other unlawful acts" which were "not genuine efforts to influence public officials" was proper under the case law, the facts of this case, and in light of the instructions submitted by the parties.

In *Noerr,* the Court stated that when a "campaign, ostensibly directed toward influencing governmental action, is a mere sham to cover what is actually nothing more than an attempt to interfere directly with the business relationships of a competitor * * * the application of the Sherman Act would be justified." *Noerr,* 365 U.S. at 144, 81 S.Ct. at 533.[11]

In *Pennington,* 381 U.S. 657, 85 S.Ct. 1585, 14 L.Ed.2d 626 however, the Court cautioned:

> Joint efforts to influence public officials do not violate the antitrust laws even though intended to eliminate competition. Such conduct is not illegal, either standing alone or as part of a broader scheme itself violative of the Sherman Act. The jury should have been so instructed.

*Id.* at 670, 85 S.Ct. at 1593.

In *California Motor Transport,* 404 U.S. 508, 92 S.Ct. 609, 30 L.Ed.2d 642 the Court first applied the so-called "sham exception" to the *Noerr-Pennington* doctrine. There, the defendants maintained a trust fund which they used to oppose all license applications by their competitors with or without probable cause and regardless of the merits of the applications. The Court affirmed the Ninth Circuit's reversal of a district court order dismissing plaintiffs' antitrust action on *Noerr-Pennington* grounds because it found that the defendant's activities may not have been genuine efforts to influence the government but instead may have been simply a "combination of entrepreneurs to harass and deter their competitors from having 'free and unlimited access' to the agencies and courts, to defeat that right by massive, concerted, and purposeful activities." 404 U.S. at 515, 92 S.Ct. at 614.

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[11] The *Noerr* Court noted, however, that the defendants' activities—even though they included misrepresentations and unethical conduct—were not covered by the Sherman Act at least insofar as those activities comprised mere solicitation of governmental action with respect to the passage and enforcement of laws. 365 U.S. at 140–42, 81 S.Ct. at 531–32. The unethical conduct referred to involved the defendants' use of the so-called "third-party technique"—a misrepresentation through which the railroad defendants' attempts to gain passage of laws favorable to railroads and unfavorable to the plaintiff trucking companies were made to appear as originating from independent parties. However, even though the use of this third-party technique involved misrepresentation as to the source of the petitioning, the position advanced by the defendants—essentially that trucks were harmful to the state's highways and interfered with motorists' rights—was a legitimate one, "conducted along lines normally accepted in our political system," *id.* at 145, 81 S.Ct. at 533, even though anti-competitive. The case before us is distinguishable in that the jury could properly have found, based on the facts and the court's instructions, that TCI's activities, more than being simply anti-competitive, were not genuine lobbying activities at all but instead were heavy-handed attempts to directly interfere with the business relationships of a competitor, to disturb the political process and to coerce the City into extending TCI's monopoly position, even though Central offered a superior cable system at lower cost. Much of TCI's "lobbying" made no attempt to provide the City with information on which to base a reasonable choice but, instead, sought to subvert the franchising process.

In *Otter Tail Power Co. v. United States*, 410 U.S. 366, 93 S.Ct. 1022, 35 L.Ed.2d 539 (1973), the Court described *California Motor Transport* holding

> that the principle of *Noerr* may also apply to the use of administrative or judicial processes where the purpose to suppress competition is evidenced by repetitive lawsuits carrying the hallmark of insubstantial claims and thus is within the "mere sham" exception announced in *Noerr*.

*Id.* at 380, 93 S.Ct. at 1031.

This Court has on numerous occasions explored the meaning of the *Noerr-Pennington* doctrine and its "sham" exception. For example, in *Mark Aero, Inc. v. Trans World Airlines, Inc.*, 580 F.2d 288, 296–98 (8th Cir.1978), we summarized the facts and holdings in *Noerr, Pennington* and *California Motor Transport* and then examined the meaning of the "sham" exception:

> [T]he essential element of the sham exception, whether employed in an adjudicative or nonadjudicative setting [is] an absence of a genuine effort to influence government but, rather, an intent to injure a competitor directly.
>
> * * * *
>
> The fundamental question presented in each case involving the "sham" exception, whether argued in a nonadjudicative or an adjudicative setting, is the question of intent. * * * As always in deciding questions of intent, the court considers all of the surrounding circumstances and assigns to each circumstance an appropriate weight, dependent upon the function and significance of each. Thus in *California Motor* the Court considered the "manner of exercise of the right of association and petition," the defendants' other activities against competitors, and the adamant stand taken in defendants' opposition to other applications, all to ascertain whether there was a true intent to injure competitors directly rather than to influence governmental action. The distillation of all of the applicable factors in each case governs the decision as to true intent, whether it is to directly injure competitors rather than to influence governmental action. In *California Motor* a consideration of all of the factors lead the Court to conclude that the allegations came within the sham exception in the *Noerr* case, "as adapted to the adjudicatory process" in that the defendants' purpose was to deny a competitor "free and meaningful access to the agencies and courts." [12]

We also quoted with approval from an antitrust commentator that "[c]onstruing the sham exception as enunciated in *Noerr* to include all activity not genuinely designed to influence the government is more consonant with the Court's central ruling." 580 F.2d at 296, *citing D. Fischel, Antitrust Liability for Attempts to Influence Government Action: The Basis and Limits of the Noerr-Pennington Doctrine*, 45 U.Chi.L.Rev. 80, 105 (1977).

In *Westborough Mall v. City of Cape Girardeau*, 693 F.2d 733 (8th Cir.1982), *cert. denied*, 461 U.S. 945, 103 S.Ct. 2122, 77 L.Ed.2d 1303 (1983), we again elaborated on the "sham" exception to the

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[12] The plaintiff in *Mark Aero* was an air taxi operator who wanted to reopen the Kansas City Municipal Airport for commercial flights. Two of the plaintiff's competitors opposed the reopening by conducting a publicity campaign and by exerting pressure on public officials. No illegal activities were alleged, as in the case before us, although Mark Aero did allege that the defendants "induced others to make false and misleading statements" and used "economic coercion" on City officials. We hold that the defendants' activities were protected by *Noerr-Pennington* because "none of the defendants' alleged wrongful acts constitute more than joint efforts to influence the City officials' decision in the airport controversy." 580 F.2d at 296.

*Noerr-Pennington* doctrine. There we held:

> [T]he defendants may not be protected by *Noerr* because their legitimate lobbying efforts may have been accompanied by illegal or fraudulent actions. *See Sacramento Coca-Cola Bottling Co. v. Chauffeurs, Teamsters & Helpers Local 150,* 440 F.2d 1096, 1099 (9th Cir.), *cert. denied,* 404 U.S. 826, 92 S.Ct. 57, 30 L.Ed.2d 54 (1971); *Woods Exploration & Producing Co. v. Aluminum Co. of America,* 438 F.2d 1286, 1296–1298 (5th Cir.1971), *cert. denied,* 404 U.S. 1047, 92 S.Ct. 701, 30 L.Ed.2d 736 (1972). The *Noerr-Pennington* doctrine was not "intended to protect those who employ illegal means to influence their representatives in government." *Sacramento Coca-Cola Bottling Co. v. Chauffeurs, Teamsters & Helpers Local 150, supra,* 440 F.2d at 1099. *See generally* 7 Von Kalinowski, Antitrust Laws and Trade Regulation, *supra,* § 46.04[3] at 46–55. In *Gorman Towers, Inc. v. Bogoslavsky,* [626 F.2d 607 (8th Cir.1980) ] *supra,* we recognized that actions beyond "traditional political activity" may not be protected by the *Noerr* exemption. *Id.,* 626 F.2d at 615. Because the plaintiffs have presented facts that support an inference of unlawful conduct—city officials may have been induced by the May-Drury defendants by means other than legitimate lobbying to illegally revert plaintiffs' C–4 zoning—the *Noerr* doctrine may not be relied upon to support the district court's grant of summary judgment. *See Federal Prescription Service, Inc. v. Pharmaceutical Ass'n,* 663 F.2d 253, 266 (D.C. Cir.1981), *cert. denied,* 455 U.S. 928, 102 S.Ct. 1293, 71 L.Ed.2d 472 (1982).[13]

693 F.2d at 746.

In the *Sacramento* decision cited in *Westborough Mall,* the United States Court of Appeals for the Ninth Circuit stated:

> [I]t does not seem to this Court that the doctrines of *Noerr* and *Pennington* were intended to protect those who employ illegal means to influence their representatives in government. These doctrines were enunciated to see that the antitrust laws did not impede the free flow of communication between the people and the government. But there can be little reason to extend the special immunity of *Noerr* and *Pennington* to a type of "communication" which includes threats and other coercive measures. There is no room for such tactics in a democratic system.
>
> In the case before us it was alleged that the defendant unions influenced the State Fair officials by means of threats, intimidation and other coercive measures. The doctrines of *Noerr* and *Pennington* are not, therefore, applicable.

440 F.2d at 1099

*See also In Re IBP Confidential Business Documents Litigation,* 755 F.2d 1300, 1313 (8th Cir.1985) (*Noerr-Pennington* doctrine cannot be extended to "activities which, although 'ostensibly directed toward governmental action,' are actually nothing more than an attempt to harm another" or to "false communications" or to tortious, violent, defamatory or other illegal acts [citations omitted].).

We think that the trial court's jury instruction adequately informed the jury of the *Noerr-Pennington* doctrine and the sham exception.[14] The instruction does not

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[13] TCI alleges that the defendants in *Westborough Mall* attempted to bribe public officials. However, our reading of that case reveals that it did not invoke the sham exception on grounds of bribery but on the ground that the plaintiffs might be able to prove an illegal conspiracy between defendants and the City which included illegal private negotiations such as those at issue in the case before us.

[14] TCI also alleges that the trial court's conspiracy instruction "essentially negated" the *Noerr-Pennington* defense. We reject this argument. First of all, TCI did not specifically raise this objection below, and thus we could order a new trial on this basis only if the alleged error is "plain error." In any event, we find TCI's oblique argument to be completely without merit. We find nothing in the conspiracy instruction which negates the *Noerr-Pennington* instruction. The jury was informed that "each * * * instruction is equally binding upon you." Conspiracy Instruction Number 11 read along with Instruc-

: the problem that the instruction which disapproved in *Pennington* had. It not state that legal petitioning activi- can be illegal if accompanied by anti- petitive intent. Instead, it describes essence of the "sham" exception—were ndant's petitioning activities genuine mpts to influence government action, vere they designed to directly interfere the business relationships of a compet- ?

] Finally, our review of the record als full support for the jury's and trial ge's conclusion that TCI overstepped boundaries of *Noerr-Pennington* pro- on. Much of TCI's campaign was not ted at informing public officials or the ic of TCI's position. Instead, TCI ght to distort the process by refusing to icipate in the RFP process, by threaten- the City's consultant and one of its petitors, by withholding the past due chise fee, by attempting to interfere Central's financing, and by coercing City into holding private negotiations in tion of the RFP terms and Missouri's hine laws. Indeed, TCI's argument ld effectively repeal the sunshine laws administrative laws prohibiting *ex e* contacts. TCI's argument that *r-Pennington* allows them to engage xcessive and intimidating conduct ed too much for the trial judge and and it proves too much for us.[15]

### C. State Action Defense.

TCI contends that Central could not have a cause of action under the antitrust laws because the City is immune under the state action doctrine. Central contends that this argument is without merit because there is no clearly and affirmatively expressed policy of the Missouri legislature directing the City to displace competition, and TCI's agreement with the City is not in furtherance of any such policy. Central also argues that, in any event, TCI did not raise its "state action" argument in its answer, motion to dismiss, motion for summary judgment, pretrial filings, or its statement of issues in this Court. It points out that, in fact, TCI took precisely the opposite position below, stating in its j.n.o.v. motion that the City's actions were not "state action." Although we doubt that TCI's "state action" argument has merit, we decline to reach it because "defenses not raised or litigated in the trial court cannot be urged for the first time on appeal." *Gardner v. Meyers*, 491 F.2d 1184, 1190 (8th Cir.1974).

### D. Evidentiary Rulings.

**[5]** TCI raises numerous objections to the trial court's evidentiary rulings and contends that the trial court gave improper and confusing instructions to the jury. Af-

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as Number 21 and Number 14 (*Noerr-Pen- gton*) fully informed the jury that before any itrust liability could be imposed, it had to d that TCI "knowingly entered into a combi- ion or conspiracy" and that in determining bility, it could not consider TCI's "legitimate bying efforts."

Central raises several other reasons why I's conduct was not protected under *Noerr- nnington.* Although some of these arguments y have merit, we need not reach them here. ntral argues that the *Noerr-Pennington* doc- ne is inapplicable here because this case in- ves a municipality acting in an essentially nmercial rather than in an executive, legisla- : or adjudicatory capacity. *See, e.g., Sacra- nto,* 440 F.2d at 1099; *Hecht v. Pro-Football,* ., 444 F.2d 931, 941–42 (D.C.Cir.1971), *cert. tied,* 404 U.S. 1047, 92 S.Ct. 701, 30 L.Ed.2d (1972); *George R. Whitten, Jr. v. Paddock d Builders, Inc.,* 424 F.2d 25, 33 (1st Cir.), *cert. denied,* 400 U.S. 850, 91 S.Ct. 54, 27 L.Ed.2d 88 (1970). Central also argues that TCI's conduct cannot be described as merely "political" in nature because the ultimate act it sought from the City, the award of a cable television franchise, is not protected "state action" because there is no clearly and affirmatively expressed policy in Missouri authorizing cities to displace competition in the cable television industry. *See, e.g., Community Communications Co. v. City of Boulder,* 455 U.S. 40, 102 S.Ct. 835, 70 L.Ed.2d 810 (1982). Finally, Central argues that the *Noerr-Pennington* doctrine is inapplicable because the jury found that there was an illegal conspiracy between TCI and certain City officials, including Utterback and the mayor. *See, e.g., Affiliated Capital Corp. v. City of Houston,* 735 F.2d 1555, 1566–67 (5th Cir.1984), *cert. denied,* — U.S. —, 106 S.Ct. 788, 88 L.Ed.2d 766 (1986); *Duke & Co. v. Foerster,* 521 F.2d 1277, 1281–82 (3d Cir.1975).

ter a thorough review of the record, the jury instructions as a whole, and the trial court's lengthy explanation of its evidentiary rulings and jury instructions, we find that many of TCI's objections were not properly preserved for appeal and, in any event, that the trial court did not abuse its discretion in its evidentiary rulings, that the jury instructions adequately stated the law, and that the court's allowance of ninety minutes per side for closing arguments was not an abuse of discretion.

### E. Monopoly Power in a Regulated Market.

[6] TCI contends that, as a matter of law, it could not have possessed monopoly power because Jefferson City regulated price and entry in the cable television business. We reject this argument. Monopoly power is the power to control prices or exclude competitors. *United States v. Grinnell Corp.*, 384 U.S. 563, 571, 86 S.Ct. 1698, 1704, 16 L.Ed.2d 778 (1966). Here, TCI had the power to raise the price of "premium" channels without the approval of the City. Most significantly, TCI used its entrenched position and the various unethical or illegal practices outlined in our *Noerr-Pennington* discussion to exclude competition.

TCI miscites our decision in *National Reporting Co. v. Alderson Reporting Co.*, 763 F.2d 1020 (8th Cir.1985), as establishing that a company cannot possess monopoly power in a regulated market. There, the United States Tax Court contracted on a yearly basis for court-reporting services. The court allowed contractors who performed satisfactorily to renew their contract at the previous year's rate. If, however, the contractor wanted to raise his price, the court put the contract out for bid. When National Reporting Company, which had the current contract, requested a price increase, the court let the contract out for bid. Alderson Reporting Company submitted a bid more than 300 percent lower than National's bid, and received the contract. National then brought an antitrust action against Alderson, alleging that Alderson submitted a predatory below-cost bid with the intent to drive competitors out of the market and create a monopoly. We reversed a district court judgment in favor of National, and held that Alderson could not possess monopoly power because it did not have the power to control prices or exclude competition. National's theory was that Alderson submitted a predatory bid and then would increase prices the next year. However, we pointed out that as soon as Alderson raised its price, the contract would be put out for bid and that "[c]ompetition is alive and well in the relevant market." *Id.* at 1023.

That factual situation is completely inapposite to our case. Unlike TCI, Alderson had not threatened competitors into not submitting bids, and it took no other action to destroy the competitive bidding process. The mere fact that the Jefferson City cable market is regulated cannot hide the fact that TCI had monopoly power in the market, and it used that power and other methods other than superior ability to exclude competition. As the United States Supreme Court stated in *Otter Tail Power Co. v. United States*, 410 U.S. 366, 372, 93 S.Ct. 1022, 1027, 35 L.Ed.2d 359 (1973), "Activities which come under the jurisdiction of a regulatory agency nevertheless may be subject to scrutiny under the antitrust laws."

### F. Sufficiency of the Evidence on the Conspiracy Count.

[7] TCI contends that we must overturn the jury's verdict on Section One of the Sherman Act because there is insufficient evidence of a conspiracy or combination. Central contends that TCI is merely repeating an argument rejected by the jury, and it argues that if there is any evidence supporting the jury's finding of a conspiracy, the finding must be upheld. *Citing Weiss v. York Hospital*, 745 F.2d 786, 814 (3d Cir.1984), *cert. denied*, 470 U.S. 1060, 105 S.Ct. 1777, 84 L.Ed.2d 836 (1985). TCI contends that it was selected because this was the "best" business decision for the City, even though Central offered a state-

of-the-art system with a greater number of channels and better picture quality at a lower price. TCI stresses that there would have been an interruption in service if Central had been chosen, and that the mayor and other City officials were merely responding to this eventuality. "An inference of conspiracy is not warranted where the conduct is at least as consistent with legitimate business decisions * * * as with [anti-competitive joint action]." *Admiral Theatre Corp. v. Douglas Theatre Co.*, 585 F.2d 877, 884 (8th Cir.1978).

Central contends that TCI's argument "emphasizes the innocuous and ignores the ominous." *Corey v. Look*, 641 F.2d 32, 35 (1st Cir.1981) (holding that concerted action by city officials and a parking lot operator designed to subvert normal commercial bidding and exclude the plaintiff violated Section One of the Sherman Act). Central contends that the record reveals abundant evidence that various City officials were coerced and pressured into an anti-competitive position. We find this a difficult question. Nonetheless, after reviewing the lengthy record in detail, we believe that overturning the jury's conspiracy verdict would require us to review the evidence *de novo* and to accord little respect for the verdict of what the trial judge termed was "an extremely attentive jury." *Central Telecommunications*, 610 F.Supp. at 894.

### G. Damages.

#### 1. *Fact of Damage.*

TCI contends that under *Duff v. Kansas City Star Co.*, 299 F.2d 320 (8th Cir.1962), an unestablished business cannot recover for injury to "business" under section 4 of the Clayton Act. There, we stated that a plaintiff may not recover antitrust "damages by reason of loss of anticipated profits in an anticipated business." *Id.* at 323. However, this statement must be read in light of the facts in *Duff.* Duff had operated a small weekly newspaper in Kansas City, Missouri. After eight years of non-publication due to a newsprint shortage during World War II, he unsuccessfully sought to reenter the newspaper business. He claimed that his inability to start up a newspaper again was due to an attempt by defendant to monopolize the market. The district court dismissed his antitrust action on the ground he had no "business or property" which could have been injured. This Court affirmed, finding: "After eight years of non-publication appellant possessed neither business nor property, including goodwill, which could have been damaged[.]" *Id.* at 325. Stressing that Duff had not made any large capital expenditures, did not own a copyrighted name for a newspaper which had a value, and did not have subscription, advertising, or financing commitments, the Court stated that Duff "was in no different position than any stranger who might arrive in Kansas City with the desire or wish to enter the newspaper publishing field and who claimed that because of appellees' monopoly he was prevented from doing so." *Id.* at 323.

Although neither the Supreme Court nor this Court has had occasion to expound on the meaning of *Duff*, at least seven of the Circuit Courts of Appeal,[16] as well as numerous district courts,[17] and the Supreme Court by implication[18] have ruled that an unestablished business can recover future lost profits under the federal antitrust laws if a sufficiently advanced state of preparation for entering a market has been achieved. For example, the same year that *Duff* was decided, the United States Court of Appeals for the Fifth Circuit rejected a contention that *Duff* established that a business in the planning stage may never recover anticipated profits under the federal antitrust laws:

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[16] *Parks v. Watson*, 716 F.2d 646, 659–60 (9th Cir.1983); *Grip-Pak, Inc. v. Illinois Tool Works, Inc.*, 694 F.2d 466, 475 (7th Cir.1982), *cert. denied*, 461 U.S. 958, 103 S.Ct. 2430, 77 L.Ed.2d 1317 (1983); *Huron Valley Hospital Inc. v. City of Pontiac*, 666 F.2d 1029, 1033 (6th Cir.1981); *Hayes v. Solomon*, 597 F.2d 958, 973 (5th Cir. 1978), *cert. denied*, 444 U.S. 1078, 100 S.Ct. 1028, 62 L.Ed.2d 761 (1980); *Hecht v. Pro-Football, Inc.*, 570 F.2d 982, 987–88 (D.C.Cir.1977), *cert. denied*, 436 U.S. 956, 98 S.Ct. 3069, 57 L.Ed.2d 1121 (1978); *Triangle Conduit & Cable Co. v. National Electric*, 152 F.2d 398, 400 (3d Cir. 1945); *Pennsylvania Sugar Ref. Co. v. American Sugar Ref. Co.*, 166 F. 254 (2d Cir.1908).

[17] *See, e.g., Bowl America, Inc. v. Fair Lanes, Inc.*, 299 F.Supp. 1080, 1095 (D.Md.1969); *Denver Petroleum Corp. v. Shell Oil Co.*, 306 F.Supp. 289, 307 (D.Colo.1969).

[18] *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 126–28, 89 S.Ct. 1562, 1578–79, 23 L.Ed. 1562 (1969) (On the related question of whether the plaintiff, as a condition of maintaining a treble-damage action, must prove

> Defendant's argument necessarily presupposes that when Congress authorized treble damage suits it meant to distinguish between the rights of persons who are put out of business and the rights of persons who are kept out of business by a conspiracy. It is unreasonable to suppose that such a distinction was intended by Congress. The purpose of the antitrust laws is to promote competition and to prevent its restraint. This purpose is no less thwarted when a person who intends and is prepared to embark in trade is stopped at the outset, than it is when a going business is brought to a standstill. It is as unlawful to prevent a person from engaging in business as it is to drive him out of business. *Thomsen v. Union Castle Mail S.S. Co.*, 2 Cir., 1908, 166 F. 251, 253. The restriction which defendants would place upon the meaning of the word "business" is unwarranted in the context of its Clayton Act usage.
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> We see no conflict in the holding of the Duff case with the decision reached here. First, the Duff case presents facts entirely different from those under consideration here. Indeed, the trial court likened the plaintiff in Duff to a stranger who might enter Kansas City "with the desire or wish" to enter the newspaper publishing field; which is to say that the "desire or wish" is all the stranger had. No property was involved. In effect, the court held that there was no established business (good will) to which the name or trademark there involved attached.
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> [By contrast, the plaintiff here] was guilty of no lethargy or speculative assertion of a mere wish, desire or intention to engage in business. In July he bound himself by the terms of a contract, which the evidence indicates would have been in performance in December. The alleged conspiracy stopped him cold in November. It is our opinion that Young was "injured in his business or property".

*North Texas Producers Association v. Young*, 308 F.2d 235, 243 (5th Cir.1962), *cert. denied*, 372 U.S. 929, 83 S.Ct. 874, 9 L.Ed.2d 733 (1963).

A respected commentator has aptly summarized the now-established majority view:

> The plaintiff will be deemed to have an existing "business" if he has an intention to do so and has made a sufficient degree of preparation toward entering the market or industry. The four elements that the courts have considered in determining the degree of intention and preparedness are:
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> (1) the plaintiff's background and experience in his prospective business;
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> (2) affirmative action on the plaintiff's part to engage in the proposed business;
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> (3) his ability to finance the business and to purchase the necessary equipment and facilities to engage therein; and
>
> (4) His consummation of contracts.

10 Von Kalinowski, Antitrust Laws and Trade Regulation, § 115.02[3][i] (1986) (footnotes omitted). *See also e.g., Parks*, 716 F.2d at 660.

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that he made a demand for the excluded product or service, the Court stated: "The issue is whether, once the embargo was lifted, Zenith wanted to enter, had the capacity to do so, and was prevented from entering by its inability to secure a patent license and by other operations of the English patent pool. Section 4 of the Clayton Act required that Zenith show an injury to its 'business or property by reason of anything forbidden in the antitrust laws.' If Zenith's failure to enter the English market was attributable to its lack of desire, its limited production capabilities, or to other factors independent of HRI's unlawful conduct, Zenith would not have met its burden under § 4." (Footnote omitted.)

We agree with the conclusion of the United States Court of Appeals for the Fifth Circuit in *North Texas Producers Association* that *Duff* is consistent with this majority view, but simply holds that Duff had not shown sufficient business or property interests to recover for injury to "business or property" under section 4 of the Clayton Act.

**[8]** The district court tracked this view by instructing the jury that "[i]t is necessary that plaintiff cause you to believe from the evidence an intention and preparedness to enter the cable television market in order to recover for its loss in this case." TCI does not challenge this instruction on appeal. Our review of the record supports the jury's conclusion that Central had made sufficient preparations to enter the cable television business to recover for injury to "business" under section 4 of the Clayton Act. Central had experience and expertise in the cable field, had raised over $300,000 in capital with commitments of an additional $200,000 in capital, had secured financing commitments in excess of $1.5 million, had submitted detailed feasible plans for its cable system in Jefferson City and had secured the vote of the City Council for an operating franchise.

**[9]** TCI also contends that the tortious interference verdict must be reversed because under Missouri's tortious interference law, an unestablished business cannot recover anticipated profits unless plaintiff proves past income and expenses as the basis for computing them. *Citing Coonis v. Rogers,* 429 S.W.2d 709, 713–14 (Mo. 1968). However, our review of Missouri law reveals that this argument is too extreme. A more detailed, accurate and recent description of Missouri law was provided in *Budget Rent-A-Car v. B & G Rent-A-Car,* 619 S.W.2d 832, 836–37 (Mo. App.1981), where the court wrote:

> [T]he loss of profits, whether past or future, claimed to arise out of exclusion from a market is customarily not susceptible of detailed or direct proof, and * * * unless proof of an inferential character is permitted, the result would be to immunize a defendant from the consequences of his wrongful acts. That principle has been frequently enunciated by the Supreme Court of the United States in the context of actions to recover damages resulting from violations of the Federal antitrust laws. * * * The principle is equally applicable where the claim of lost profits arises from a violation of fiduciary obligations or breach of contract. * * *
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> * * * "The assessment of damages by a trial court sitting without a jury will not be set aside unless manifestly erroneous; and may be upheld if it falls within the range of estimates given by expert witnesses."
>
> [There has been an] evolution away from the demand for proof of certainty in damages in actions of this nature in * * * Missouri. * * * Anticipated profits were generally not recoverable. *Coonis v. Rogers,* 429 S.W.2d 709, 714 (Mo.1968), but note the further quote, " 'They [anticipated profits] may be recovered only when they are made reasonably certain of proof of actual facts, with present data for a rational estimate of their amount; and, when this is made to appear, they may be recoverable.' " * * * "[T]he law is also well settled that damages may be recovered for loss of profits due to the breach of a contract if the evidence is sufficiently certain and definite to warrant the jury in estimating their extent." * * * "It has been said, however, that the amount of estimated loss of earnings (and the same would apply to loss of prospective profits) should, in the event of uncertainty, at least be supported by the best evidence available." * * *
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> * * * "Where computation of damages is made uncertain by the nature of the breach of contract, '[t]he most elementary conceptions of justice and public policy require that the wrongdoer shall bear the risk of the uncertainty which his own wrong has created.' * * * [.]" [Citations omitted.]

Similarly, in *Coach House of Ward Parkway v. Ward Parkway Shops,* 471 S.W.2d 464, 472–73 (Mo.1971), the Court stated:

Defendant relies on a line of cases exemplified by *Coonis v. Rogers*, Mo., 429 S.W.2d 709, and *Anderson v. Abernathy*, Mo., 339 S.W.2d 817, for the general proposition of law to the effect that recovery of anticipated profits of a commercial business are too remote, speculative to warrant recovery except where they are made reasonably certain by proof of actual facts with present data for a rational estimate of their amount. This is and has been the rule in Missouri. However, in *Hargis v. Sample*, Mo., 306 S.W.2d 564, 569, also cited by defendant, this court in speaking of the certainty with which loss of profits must be shown said: "True, in some cases all that can be required is to produce all the relevant facts tending to show the extent of damage and one is not to be excused for a breach of contract resulting in damages simply because those damages may not be established with exact certainty. *Wright v. Ickenroth*, Mo.App., 215 S.W.2d 43, 45. It has been said, however, that the amount of estimated loss of earnings (and the same would apply to loss of prospective profits) should, in the event of uncertainty, at least be supported by the best evidence available. *Moss v. Mindlin's, Inc.*,, Mo., 301 S.W.2d 761, 773."

> We believe this case comes within [this] rule * * * where if the breach exists, the experience of mankind is convincing that a pecuniary loss has occurred while at the same time the exact amount of damage is not susceptible of being ascertained with certainty.

The Court in *Coach House* then held that damages for lost profits could be recovered, on remand, on the basis of the testimony of an expert witness on the estimated loss of business due to the violation at issue.

We think this is the type of case where the damage award was based on the best evidence available, and where the estimate of loss is reasonable and thus is not too speculative under Missouri law. In sum, we hold that Central has sufficiently proved that it suffered damage to a protectable interest under the federal antitrust law and the State of Missouri's law on tortious interference with a business expectancy.

2. *Measure of Damages.*

TCI contends that Central's damage theory was "irrational" and overcompensatory because it allegedly failed to deduct all the "start-up" costs of the business. Central's theory was that it should receive the fair market value of the lost franchise, and this value was ascertainable through use of an "industry rule of thumb"—ten times cash flow in Central's proposed third year of operations. Central cites controlling authority that the fair market value of a business has long been a recognized measure of damages for a precluded plaintiff in antitrust cases, *see, e.g. Arnott v. American Oil Co.*, 609 F.2d 873, 887 (8th Cir. 1979), *cert. denied*, 446 U.S. 918, 100 S.Ct. 1852, 64 L.Ed.2d 272 (1980); *Albrecht v. Herald*, 452 F.2d 124 (8th Cir.1971). *See also Affiliated Capital Corp. v. City of Houston*, 519 F.Supp. 991, 1011 (S.D.Tex. 1981), *rev'd on other grounds*, 735 F.2d 1555 (5th Cir.1984). Central also cites to *Malley-Duff & Associates, Inc. v. Crown Life Ins. Co.*, 734 F.2d 133, 148 (3d Cir.), *cert. denied*, 469 U.S. 1072, 105 S.Ct. 564, 83 L.Ed.2d 505 (1984) where the Court approved the use of an industry rule of thumb—a multiplier times vested renewal income—to determine fair market value.

Central introduced a detailed damages study and extensive supporting testimony. The jury arrived at an actual damage amount of $10.8 million. Central points out that TCI itself suggested that the fair market value of the Jefferson City cable franchise was between $7.7 and $15 million. Although the damage award is large, we have concluded that we are obligated under controlling authority and the facts of the case to affirm. First of all, the Supreme Court has repeatedly made clear that once the fact of damage is established, the amount of damages requires a lesser degree of proof. *See, e.g., J. Truett Payne Co. v. Chrysler Motors Corp.*, 451 U.S. 557, 565–67, 101 S.Ct. 1923, 1929, 68 L.Ed.2d 442 (1981) ("Our willingness to accept a degree of uncertainty in these cases rests in part on the difficulty of ascertaining business damages as compared, for example, to damages resulting from a personal injury. * * * The vagaries of the marketplace usually deny us sure knowledge of what plaintiff's situation would have been in the absence of the defendant's antitrust violation.") For example, in *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 123–24, 89 S.Ct. 1562, 1576–77, 23 L.Ed.2d 129 (1969), the Court held that antitrust damages could be awarded on the basis of plaintiff's estimates of sales it could have made absent the violation:

> [D]amage issues in these cases are rarely susceptible of the kind of concrete, detailed proof of injury which is available in other contexts. The Court has repeatedly held that in the absence of more precise proof, the fact-finder may "conclude as a matter of just and reasonable inference from the proof of defendants' wrongful acts and their tendency to injure plaintiffs' business, and from the evidence of the decline in prices, profits and values, not shown to be attributable to other causes, that defendants' wrongful acts had caused damage to the plaintiffs."

A respected commentator has summarized the law on the measure of antitrust damages as follows:

> The amount of damages may be established by evidence of facts from which some calculation may be logically and legally inferred. If the inference upon which the award is based is reasonable, the plaintiff may recover a sum in damages even if it is merely an approximation.

10 Von Kalinowski § 115.02[2] (1986) (footnotes omitted).

Similarly, the United States Court of Appeals for the Seventh Circuit has recently reiterated, in a decision affirmed by the Supreme Court: "Because a plaintiff can seldom prove the exact amount of antitrust damages, he may sustain his burden with circumstantial evidence and estimates of damage based on reasonable assumptions." *Spray-Rite Service Corp. v. Monsanto Co.*, 684 F.2d 1226, 1242 (7th Cir.1982), *aff'd in part, rev'd in part on other grounds*, 465 U.S. 752, 104 S.Ct. 1464, 79 L.Ed.2d 775 (1984). The law of the State of Missouri is similar with respect to damages for tortious interference with business expectancy. *See, e.g., Budget Rent-A-Car*, 619 S.W.2d at 836–37.

[10] Central presented an estimate of damages based on reasonable industry assumptions, and the jury was entitled to infer from the evidence actual damages in an amount of $10.8 million. Our review of the award fails to reveal any error,[19] and we could reduce the award only by acting as the *de novo* fact-finder. This we may not do.

Perhaps most significantly, Central's damage study and its expert's testimony was admitted without objection. TCI failed to introduce evidence on damages, and did not argue damages in its final argument before the jury. It is apparent that TCI made a conscious decision to "go for broke," claiming that Central could simply not receive any damages at all because TCI was not liable. The jury rejected this argument and was forced to base its damage award on the evidence before it. TCI first objected to the damages award and its method of calculation in its post-trial motion. This was too late. Accordingly, the actual damages award of $10.8 million on the antitrust (before mandatory trebling) and tortious interference claims is affirmed.

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[19] TCI contends, in an argument not raised before the jury, that Central's damage estimate failed to adequately account for Central's start-up costs. However, our review of the damages study reveals that start-up costs of $1.6 million were accounted for. If TCI believed this figure understated start-up costs, it should have introduced evidence on this. Given that TCI failed to raise this argument before the jury, and that there is no evidence to suggest that Central's estimate is unreasonable, we assume that $1.6 million in estimated start-up costs is reasonable.

TCI also suggests in passing that Central's damages theory erroneously uses its third year of operations as the base for determining fair market value. However, TCI failed to object to this method at trial. Moreover, the third year coincided with the date of trial, and thus had a reasonable basis.

[11] The jury also awarded $25 million in punitive damages on the tortious interference claim. TCI does not challenge this award on appeal other than contending that if the actual damages award is reversed, the punitive damages award must also be reversed. Accordingly, although the punitive damages award is large, the award was based on a jury instruction on punitive damages which was not objected to at trial or on appeal and which, in any event, accurately sets forth the law of the State of Missouri. The record reveals substantial evidence of intentional tortious conduct on which the punitive damages award was based. Accordingly, we affirm the jury's award.

Affirmed.

**C.H. BETTERTON, Appellant,**

**v.**

**FIRST INTERSTATE BANK OF ARIZONA, N.A., a National Banking Association and Paula Stiles, Appellees,**

**v.**

**C.H. BETTERTON, Appellant.**

**C.H. BETTERTON, Appellee,**

**v.**

**FIRST INTERSTATE BANK OF ARIZONA, N.A., a National Banking Association and Paula Stiles, Appellants,**

**v.**

**C.H. BETTERTON, Appellee.**

**Nos. 85-2410, 86-1213.**

United States Court of Appeals,
Eighth Circuit.

Submitted June 9, 1986.

Decided Aug. 29, 1986.

Rehearing Denied Sept. 26, 1986.

Debtor brought action against bank alleging breach of contract, fraud, conversion, breach of security agreement and tortious violation of duty of good faith arising out of bank's repossession and sale of tractor and trailer. The United States District Court for the Eastern District of Missouri, George F. Gunn, Jr., J., 615 F.Supp. 72, granted defendants' motion for summary judgment and debtor appealed. The Court of Appeals, Arnold, Circuit Judge, held that repossession of tractor and trailer after bank promised to forego repossession, in exchange for promise by debtor to have his broker subtract money owed bank from his paycheck and transferred to bank, established cause of action against bank for breach of contract, fraud and conversion.

Affirmed in part, reversed in part and remanded.

**1. Contracts ⇐54(1)**

Under Arizona law debtor's promise to have his broker subtract money owed him from his paycheck and transfer it to bank supplied consideration necessary to make bank officer's promise to forego repossession binding.

**2. Fraud ⇐12**

Under Arizona law bank officer's representations, which induced debtor to arrange with his broker to have his broker subtract money owed from his paycheck and transfer it to bank in exchange for bank's promise to forego repossession on debtor's tractor and trailer, which debtor was not obligated to make, established cause of action for fraud on the part of bank and bank officer.

**3. Trover and Conversion ⇐5**

Under Arizona law debtor who promised to have his broker subtract money owed him from his paycheck and transferred to bank in exchange for bank's promise to forego repossession established cause of action for conversion after bank repossessed property and failed to return certain items of personal property taken from debtor when truck was repossessed.

in these transactions are the *New York Dock* conditions imposed in the 1982 orders and not the *Mendocino Coast* conditions which are usually imposed on exempt lease transactions. The ICC decisions on Plaintiffs' petitions are currently pending.

Plaintiffs devote their extensive argument to the merits of their contentions. The Court, however, does not reach these merits but begins instead with an analysis of its jurisdiction over the dispute.

[1] Plaintiffs argue that jurisdiction is proper under 49 U.S.C. § 11705, which enables Plaintiffs to bring a civil action to enforce ICC orders. Because the recent ICC Notices of Exemption do not include an order regarding the appropriate employee protective conditions, Plaintiffs argue that they are attempting to enforce the 1982 orders which imposed *New York Dock* conditions. Although Plaintiffs have the right to bring an action in this Court to enforce the 1982 orders, 49 U.S.C. § 11705, the Court also has the right to refer questions or issues to the ICC for determination. 28 U.S.C. § 1336(b).

Before the Court can enforce the 1982 orders or grant Plaintiffs' present request for relief, the Court must first determine whether the transactions contemplated by Guilford probably fall within the scope of those orders. This determination, however, must be made in the exceedingly complex regulatory context of an ICC-supervised merger. The Court finds that this determination is best made by the ICC.

[2] In addition, the Court *sua sponte* determines that the doctrine of primary jurisdiction applies to the controversy before it despite Plaintiffs' ability to bring a civil action in this Court under 49 U.S.C. § 11705(a). *Cf. Hansen v. Norfolk & Western Ry.*, 689 F.2d 707, 709–11 (7th Cir.1982) (applying doctrine under section 11705(c)(1)). The ICC, and not the Court, should be given the opportunity to evaluate Plaintiffs' claims and determine the applicability of its 1982 orders to the leases in question. *See Zapp v. United Transportation Union*, 727 F.2d 617, 625 (7th Cir. 1984) (invoking doctrine so ICC could clarify plaintiffs' rights); *Anderson v. United Transportation Union*, 557 F.2d 165, 169 (8th Cir.1977) (affirming dismissal of action for damages and injunctive relief where ICC had primary jurisdiction to determine compliance with its prior order); *Augspurger v. Brotherhood of Locomotive Engineers*, 510 F.2d 853, 857 (8th Cir.1975). Moreover, deference to the administrative agency is particularly appropriate here as the issue is currently pending before the agency in the context of its Notices of Exemption.

Accordingly, the Court DENIES Plaintiffs' Application for a Temporary Restraining Order and DISMISSES Count I of the Complaint for lack of subject matter jurisdiction, or in the alternative, DECLINES jurisdiction as to Count I and refers the issue to the ICC for determination.

So ORDERED.

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**H.R.M., INC., doing business as Kearney Cablevision, Plaintiff,**

**v.**

**TELE-COMMUNICATIONS, INC., TCI North Central, Inc., Horizon Tele-Communications, Inc., Defendants.**

Civ. A. No. 86–A–2534.

United States District Court,
D. Colorado.

Jan. 30, 1987.

An antitrust action was filed against a parent corporation and its subsidiaries, which were in the business of providing cable television programming. A motion to dismiss was filed. The District Court, Arraj, J., held that: (1) sister subsidiaries could not conspire with their parent or with each other for purposes of Sherman Act;

(2) an allegation that the parent and subsidiaries conspired with "others" was insufficient to withstand a motion to dismiss for failure to state a claim; and (3) the provision of cable television programming was a "service," not a commodity within the meaning of the statute prohibiting price discrimination in the sale of commodities.

Motion to dismiss claims granted.

**1. Federal Civil Procedure ⇐1784**

Standard to be applied on motion to dismiss for failure to state claim is even more stringent in evaluation of antitrust claims, where proof is in hands of alleged conspirators, and dismissals prior to giving plaintiff ample opportunity for discovery should be granted very sparingly. Fed. Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

**2. Federal Civil Procedure ⇐1784**

Conclusory allegations which merely recite litany of antitrust will not suffice to withstand motion to dismiss for failure to state claim. Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

**3. Monopolies ⇐12(1.16)**

Subsidiaries which shared common purpose with their parent corporation could not conspire in violation of Sherman Act. Sherman Anti-Trust Act, § 1, 15 U.S.C.A. § 1.

**4. Monopolies ⇐12(1.16)**

Sister subsidiaries could not conspire with one another in violation of Sherman Act. Sherman Anti-Trust Act, § 1, 15 U.S.C.A. § 1.

**5. Monopolies ⇐12(1.16)**

Rule that parent corporation and its wholly owned subsidiaries must be viewed as single enterprise forecloses claim of conspiracy to monopolize in violation of Sherman Act. Sherman Anti-Trust Act, § 2, 15 U.S.C.A. § 2.

**6. Monopolies ⇐28(6.4)**

Allegation that parent corporation and its subsidiaries conspired with "others" was too vague to withstand motion to dismiss for failure to state claim. Sherman Anti-Trust Act, § 1, 15 U.S.C.A. § 1; Fed. Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

**7. Trade Regulation ⇐911**

Provision of cable television programming is "service," not commodity within meaning of statute prohibiting price discrimination in sale of tangible commodities. Clayton Act, § 2(a), 15 U.S.C.A. § 13(a).

See publication Words and Phrases for other judicial constructions and definitions.

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Sheldon E. Friedman, David H. Wollins, Cortez & Friedman, P.C., Englewood, Colo., for plaintiff.

Robert E. Youle, Brian G. Eberle, Sherman & Howard, Denver, Colo., for defendants.

## MEMORANDUM OPINION AND ORDER

ARRAJ, District Judge.

## INTRODUCTION

This matter is before the court on the defendants, Tele-Communications, Inc. (TCI), TCI North Central, Inc. (North Central), and Horizon Tele-Communications, Inc. (Horizon's) motion to dismiss the third and fifth claims of plaintiff's complaint for failure to state a claim upon which relief can be granted. The parties have submitted briefs in support of their respective positions on this motion, and after review of the materials submitted by the parties, I find that oral argument would not be helpful in the resolution of these issues.

## BACKGROUND

Plaintiff H.R.M., Inc., d/b/a Kearney Cablevision, is a Nebraska corporation in the business of providing cable television services to consumers and organizations in Nebraska. Defendant TCI, a Delaware corporation, is a national communications organization in the business of providing cable television services to consumers and organizations through its operating groups and subsidiaries. Defendants North Central and Horizon are wholly-owned subsidiaries of TCI, and provide cable television services to subscribers in Kearney, Nebraska and the surrounding communities.

On December 17, 1986, Kearney filed a complaint against defendants, alleging five violations of the federal antitrust laws and five pendent state law claims. Defendants filed the present motion on January 6, 1987, seeking dismissal of plaintiff's Third Claim (Conspiracy to Monopolize) and Fifth Claim (Price Discrimination) under F.R. Civ.P. 12(b)(6) for failure to state a claim upon which relief can be granted.

## DISCUSSION

**[1]** On a motion to dismiss a complaint under F.R.Civ.P. 12(b)(6), the court must consider the complaint's factual allegations as true and give the plaintiff the benefit of all reasonable inferences. *Mitchell v. King,* 537 F.2d 385, 386 (10th Cir.1976). As a rule, "a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson,* 355 U.S. 41, 45–46, 78 S.Ct. 99, 102, 2 L.Ed.2d 80 (1957). This standard is even more stringent in the evaluation of antitrust claims, where the proof is in the hands of the alleged conspirators, and dismissals prior to giving the plaintiff ample opportunity for discovery should be granted very sparingly. *Poller v. Columbia Broadcasting System, Inc.,* 368 U.S. 464, 473, 82 S.Ct. 486, 491, 7 L.Ed.2d 458 (1962); *Hospital Building Co. v. Trustees of Rex Hospital,* 425 U.S. 738, 746, 96 S.Ct. 1848, 1853, 48 L.Ed.2d 338 (1976).

**[2]** However, conclusory allegations which merely recite the litany of antitrust will not suffice. This court retains the power to insist upon some specificity in pleading before allowing a potentially massive factual controversy to proceed. *Associated General Contractors of California, Inc. v. California State Council of Carpenters,* 459 U.S. 519, 528 n. 17, 103 S.Ct. 897, 903 n. 17, 74 L.Ed.2d 723 (1983).

### A. *Count Three: Conspiracy to Monopolize.*

Plaintiff's Third Claim for relief alleges that the defendants have conspired with one another and with "others" to monopolize cable television services in the Kearney Market in violation of sections 1 and 2 of the Sherman Act, 15 U.S.C. § 1, § 2. Section 1 of the Sherman Act provides:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal ...

**[3, 4]** Plaintiff's claim that defendants conspired with each other in violation of section 1 of the Sherman Act is foreclosed by the Supreme Court's decision in *Copperweld Corp. v. Independence Tube Corp.,* 467 U.S. 752, 104 S.Ct. 2731, 81 L.Ed.2d 628 (1984). In *Copperweld,* the Supreme Court held that a parent corporation and its wholly-owned subsidiaries are legally incapable of conspiring with each other in violation of section 1 of the Sherman Act. The court expressed as the basis for its decision the unity of purpose shared by the parent and its subsidiary:

> A parent and its wholly owned subsidiary have a complete unity of interest. Their objectives are common, not disparate; their general corporate actions are guided or determined not by two separate corporate consciousnesses, but one.... With or without a formal "agreement," the subsidiary acts for the benefit of the parent, its sole shareholder.

Id. at p. 771, 104 S.Ct. at p. 2742. Therefore, North Central and Horizon share a common purpose with TCI and cannot conspire with their parent in violation of section 1 of the Sherman Act. *See also Deauville Corp. v. Federated Dept. Stores, Inc.,* 756 F.2d 1183, 1192 (5th Cir.1985); *Russ' Kwik Car Wash, Inc. v. Marathon Petroleum Co.,* 772 F.2d 214, 216 (6th Cir.1985); *Zimmerman v. Board of Publications of the Christian Reformed Church, Inc.,* 598 F.Supp. 1002, 1010 (D.Colo.1984). By the same token, neither can North Central and Horizon conspire with one another. Although the Court's holding does not explicitly preclude allegations of a conspiracy between two sister corporations, such as North Central and Horizon, the Court's rationale does apply to such situations. *Hood v. Tenneco Texas Life Ins. Co.*, 739 F.2d 1012, 1015 (5th Cir.1984); *Carl Hizel & Sons, Inc. v. Browning-Ferris Industries, Inc.*, 590 F.Supp. 1201, 1202 n. 2 (D.Colo.1984); *Satellite Financial Planning Corp. v. First National Bank of Wilmington*, 643 F.Supp. 449, 451 (D.Del. 1986).

**[5]** Plaintiff's conspiracy claim under section 2 of the Sherman Act is also foreclosed by the rationale of *Copperweld*. 15 U.S.C. § 2 provides that:

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony ...

Although section 2 does make illegal purely unilateral conduct, *Copperweld Corp. v. Independence Tube Co., supra*, 467 U.S. at p. 767 n. 13, 104 S.Ct. at p. 2740 n. 13, a claim under section 2 for conspiracy to monopolize, like a claim under section 1, requires at least two participants. 2 E. Kintner, *Federal Antitrust Law*, § 9.2 at p. 6, n. 20 (1980); 3 J. Von Kalinowski, *Antitrust Laws and Trade Regulation*, § 9.02[2] at p. 9–37 (1986). Therefore, the Court's rationale in the *Copperweld* decision—that a parent and its wholly-owned subsidiaries must be viewed as a single enterprise—also applies to foreclose a claim of conspiracy to monopolize under section 2 of the Sherman Act. *See Sadler v. Rexair, Inc.*, 612 F.Supp. 491, 494 (D.Mont.1985); *Stepp v. Ford Motor Credit Co.*, 623 F.Supp. 583, 593 (E.D.Wis.1985); *Marathon Petroleum Co. v. LoBosco*, 623 F.Supp. 129, 133 n. 2 (N.D.Ill.1985).

**[6]** Finally, plaintiff's allegation in its third claim that the defendants conspired with "others" is too vague to stand. Such a pleading is inadequate to give the defendants fair notice of plaintiff's claim. *Sadler v. Rexair, Inc., supra; Garshman v. Universal Resources Holding, Inc.*, 641 F.Supp. 1359, 1370 (D.N.J.1986). A conclusory allegation of conspiracy to restrain trade will not survive a motion to dismiss. *Lombard's, Inc. v. Prince Manufacturing, Inc.*, 753 F.2d 974, 975 (11th Cir.1985), *cert. denied*, — U.S. —, 106 S.Ct. 851, 88 L.Ed.2d 892 (1986).

### *B. Count 5: Price Discrimination.*

**[7]** Plaintiff's Fifth Claim for relief alleges that defendants have discriminated in the pricing of cable television services in the Kearner market in violation of section 2 of the Clayton Act, 15 U.S.C. § 13(a), which states in part that "[i]t shall be unlawful for any person engaged in commerce ... to discriminate in price between different purchasers of commodities ..."

Section 13(a) of the Clayton Act relates only to the sale of tangible commodities and not to services. *Baum v. Investors Diversified Services, Inc.*, 409 F.2d 872, 874 (7th Cir.1969). In this case, plaintiff's complaint alleges price discrimination only with respect to "cable television services"; nowhere in plaintiff's complaint is reference made to sale of tangible commodities. This court finds the provision of cable television programming to be a service, and not a commodity. *See Tri-State Broadcasting Co. v. United Press International, Inc.*, 369 F.2d 268, 270 (5th Cir.1966); *Satellite Television and Associated Resources, Inc. v. Continental Cablevision of Virginia, Inc.*, 714 F.2d 351, 358 (4th Cir.1983), *cert. denied* 465 U.S. 1027, 104 S.Ct. 1285, 79 L.Ed.2d 688 (1984); *American Telephone and Telegraph Co. v. Delta Communications Corp.*, 408 F.Supp. 1075, 1114 (S.D.Miss.1976), *affirmed* 579 F.2d 972 (5th Cir.1978), *modified on other grounds* 590 F.2d 100 (5th Cir.1979), *cert. denied* 444 U.S. 926, 100 S.Ct. 265, 62 L.Ed.2d 182 (1979). Therefore, since no sale or purchase of any tangible commodity is involved, plaintiff's fifth claim for relief will be dismissed.

Accordingly, it is

ORDERED that the defendants' motion to dismiss the third and fifth claims set forth in plaintiff's complaint is GRANTED.

**James DAVENPORT, Charles Richmond, Hector Rivera, Carl Lucas, Roger Pennie, Charles Terry, and Mark McBride, Plaintiffs,**

v.

**Richard W. DeROBERTIS, Michael Lane, and Michael O'Leary, Defendants.**

**No. 83 C 4392.**

United States District Court,
N.D. Illinois, E.D.

Jan. 30, 1987.

Inmates brought class action on behalf of all present and future inmates at maximum security prison confined to segregation for 90 or more consecutive days, alleging deprivation of their constitutional rights, against present and former wardens of prison and Director of Illinois Department of Corrections and seeking injunctive relief. The District Court, William T. Hart, J., held that: (1) evidence supported jury's finding of cruel and unusual punishment; (2) award of nominal damages was proper; (3) defendants were entitled to qualified immunity from compensatory or punitive damages as sued in their individual capacities; and (4) inmates confined in segregation in maximum security prison for period of 90 or more consecutive days were entitled to injunctive relief ordering that they be allowed, except during temporary emergencies and lock downs, three showers per week and five hours of out-of-cell exercise per week.

Order accordingly.

**1. Criminal Law ⇐1213.10(4)**

Testimony that general practice in maximum security prisons in civilized countries is to permit all inmates 5 to 7 hours of exercise per week, that permitting segregation inmates only one hour of out-of-cell exercise and one shower per week is "medically unacceptable," that prolonged idleness and isolation can cause mental illness and physical deterioration, and that inmates confined to segregation had experienced skin disorders, head and back pains, and musculo-skeletal problems they had not had before segregation, which problems improved when they were released from segregation, supported finding that permitting inmates confined to segregation in maximum security prison only one shower per week and only one hour of out-of-cell exercise per week, constituted cruel and unusual punishment. U.S.C.A. Const. Amend. 8.

**2. Civil Rights ⇐13.13(3)**

Jury in civil rights action was entitled to believe testimony of segregation prisoners that they suffered emotional distress, humiliation, personal indignity, and dejection as a result of denial of adequate out-of-cell exercise and showers.

**3. Civil Rights ⇐13.17(5)**

Emotional distress, humiliation, personal indignity, and dejection, which segregation inmates testified that they suffered as a result of denial of adequate out-of-cell exercise and showers were compensable actual injury under § 1983. 42 U.S.C.A. § 1983.

**4. Civil Rights ⇐13.17(5)**

Isolation in solitary confinement can cause compensable emotional damages even when there is no evidence that it caused mental or physical deterioration.

**5. Civil Rights ⇐13.17(2)**

Jury could award nominal damages of one dollar to segregation inmates who testified that they suffered emotional distress, humiliation, personal indignity, and dejection as a result of denial of adequate out-

EXHIBIT S

sentence, waived the right to reincarcerate him.

[11, 12] These claims challenge the execution of Johnson's sentence by federal prison authorities, not the validity of the sentence as imposed. They therefore do not provide a basis for relief under § 2255, but should be raised in a petition for a writ of habeas corpus under 28 U.S.C. § 2241. *See, e.g., United States v. Brown,* 753 F.2d 455, 456 (5th Cir.1985); *United States v. Giddings,* 740 F.2d 770 (9th Cir.1984); *United States v. Grimes,* 641 F.2d 96, 99 (3d Cir.1981). *See also United States v. Addonizio,* 442 U.S. 178, 99 S.Ct. 2235, 60 L.Ed.2d 805 (1979) (§ 2255 encompasses only errors which affect the lawfulness of the judgment or sentence itself); *Kiendra v. Hadden,* 763 F.2d 69 (2d Cir.1985) (granting relief under 28 U.S.C. § 2241 on grounds similar to those alleged here). A habeas petition, however, must be filed in the district in which there is jurisdiction over the prisoner or his custodian. *Brown,* 753 F.2d at 456; *Grimes,* 641 F.2d at 99 n. 7. Because Johnson is incarcerated in Ray Brook, New York, I lack jurisdiction to consider his claims regarding the execution of his sentence.

Johnson's motion to vacate, set aside or correct his sentence under 28 U.S.C. § 2255 will be denied.

**Arthur FRIEDMAN, Plaintiff,**

**v.**

**ADAMS RUSSELL CABLE SERVICES—NEW YORK, INC., Defendant.**

**No. 84 Civ. 8109 (PNL).**

United States District Court,
S.D. New York.

Jan. 15, 1986.

Cable television subscriber brought action against cable television company for damages and injunctive relief under the antitrust laws, alleging that company had abused its monopoly power by illegally tying together its provision of two levels of cable service. On company's motion for summary judgment, the District Court, Leval, J., held that cable television company's policy in making available "premium channels" only to those subscribing to its mid-level tier of programming and not to those subscribing to its basic service was not an illegal tying arrangement; company enjoyed an absolute lawful monopoly in relevant geographic market for the tied product, and thus there were no competitors harmed by arrangement.

Motion granted.

**Monopolies ⇐17.5(9)**

Cable television company's policy in making available "premium channels" only to those subscribing to its mid-level tier of programming and not to those subscribing to its basic service was not an illegal tying arrangement; company enjoyed an absolute lawful monopoly in relevant geographic market for the tied product, and thus there were no competitors harmed by arrangement. Sherman Anti-Trust Act, § 1 et seq., 15 U.S.C.A. § 1 et seq.

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Kassner & Haigney, New York City, for plaintiff.

Choate, Hall & Stewart, Boston, Mass., for defendant.

## OPINION AND ORDER

LEVAL, District Judge.

This is an action for damages and injunctive relief under the antitrust laws. The plaintiff, Arthur Friedman, alleges that the defendant, Adams Russell Cable Services, the holder of the cable television franchises in Harrison and Port Chester, New York, has abused its monopoly power by illegally tying together its provision of two levels of cable services. All material facts are undisputed. The defendant contends that plaintiff's claim fails as a matter of law, and it has accordingly moved this court for summary judgment pursuant to Rule 56(b) Fed.R.Civ.P. The motion is granted.

In 1982 the defendant acquired the cable television franchises in Harrison and Port Chester, New York, and it has been the sole provider of cable television to these communities ever since. The plaintiff is a resident of the township of Harrison, and is a subscriber of defendant's cable system. The defendant offers three tiers of cable services to its subscribers: Basic, Super-Cable, and Premium. Basic service includes primarily station signals which may also be received with a traditional VHF antenna, as well as some additional channels. Super-Cable is comprised of satellite-delivered programming such as Cable News Network, MTV, and USA Network. The Premium tier, also commonly known as "pay cable", includes Home Box Office, The Disney Channel, Sports Channel, and other movie and sports channels.

Although the various tiers are separately priced, they are not made available in all combinations. A subscriber may choose to receive only Basic service (at $4 per month), Basic and Super-Channel (for an additional $9.50 per month), or Basic, Super-Cable, and one or more of the Premium channels (at approximately $9.95 per Premium channel). Plaintiff desires to obtain certain Premium channels without subscribing to Super-Cable. The defendant will not permit this, although it admits that such a combination would present no technological problems; the Premium channels are only made available to those subscribing to Super-Cable. It is this arrangement, linking the sales of Premium channels to the sale of Super-Cable, that the plaintiff attacks as a violation of the Sherman Antitrust Act.

Superficially, the facts in this case resemble an illegal tying arrangement. As explained by the Supreme Court, "a tying arrangement may be defined as an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product ..." *Northern Pacific Railway v. United States,* 356 U.S. 1, 5, 78 S.Ct. 514, 518, 2 L.Ed.2d 545 (1958). In many circumstances the finding of a tying arrangement will be considered a *per se* violation of the antitrust laws. However, as explained by the Second Circuit in *Coniglio v. Highwood Services,* 495 F.2d 1286 (2d Cir.), *cert. denied,* 419 U.S. 1022, 95 S.Ct. 498, 42 L.Ed.2d 296 (1974), the elements of an unlawful tying arrangement are not present here.

The plaintiff in *Coniglio* contested the practice of the Buffalo Bills football team requiring season ticket purchasers to also buy tickets to a number of pre-season games. In denying this claim, the court ruled that there are four elements to an "illicit tying arrangement." The plaintiff must show: "(1) two separate and distinct products ...; (2) sufficient economic power in the tying market to coerce purchases of the tied product; (3) *anticompetitive effects in the tied market;*" and (4) a requisite volume of interstate commerce. *Coniglio, supra* at 1289 (emphasis added). Because there were "neither actual nor potential competitors to the Bills in the [Buffalo] professional football market" *id.* at 1291, the Court of Appeals concluded that there were, and could be, no anti-competitive effects of the tying arrangement. Consequently, the court denied relief under the antitrust laws.

The same hurdle proves insurmountable to the plaintiff in the instant action. The defendant enjoys an absolute lawful monopoly in the relevant geographic market for the tied product (Super-Cable). There are no competitors providing cable services in Harrison, New York, and none are likely for the remaining six years of the present franchise agreement. Thus, exactly as in the Buffalo Bills case, no competitor is harmed by the arrangement; the elements of the cause of action are not made out.

Plaintiff makes several attempts to elude the force of *Coniglio,* but none are successful. He argues that defendant's conduct should not be evaluated solely within the narrow parameters of an illegal tying arrangement, but should be seen more broadly, as an abuse of monopoly power. The same argument, however, was also made in *Coniglio*, and the court concluded that since the defendant "has not used the tying arrangement either to prevent competition or destroy it, its ticket sale practice does not represent an unlawful abuse of its monopoly power." *Coniglio, supra*, at 1293. Similarly, in *Berkey Photo v. Eastman Kodak*, 603 F.2d 263, 275 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093, 100 S.Ct. 1061, 62 L.Ed.2d 783 (1980), the Court of Appeals made it clear that as to a claim of abuse of monopoly power predicated on the extension of that power into other markets, the relevant inquiry is whether the monopolist is "using its monopoly power in one market to gain a competitive advantage in another...." Where the monopolist already possesses a lawful monopoly in both markets no competitors exist to suffer any ill effects.

The plaintiff alleges in his brief that the anti-competitive effects of defendant's conduct is felt in other towns where the defendant is able to use its inflated monopoly profits to "low ball" the competition and thus acquire additional franchises. I doubt that this argument is economically sound. It is the value of the additional franchise, as perceived by the bidders for it, that determines what each will bid and not the amount of money a bidder has earned from other ventures. If a bidder pays more for the new franchise than it is worth, he will have made a bad investment. But even if the argument were sound, it would not avail plaintiff in this cause of action. Any resulting injury would be to the competitors for those other communities and not the plaintiff. He would lack standing to prosecute their claims. *See Triple M Roofing v. Tremco*, 753 F.2d 242, 247 (2d Cir. 1985).

Plaintiff also suggests that *Coniglio* was an aberration and should no longer be considered good law. There is nothing to support this claim. Within the last year the Second Circuit has required a showing of anticompetitive effect in the tied market in order to make out an illegal tying arrangement. *See Power Test Petroleum Distr. v. Calcu Gas*, 754 F.2d 91, 96 (2d Cir.1985). Moreover, recent Supreme Court decisions are fully consistent with the position of the Second Circuit. While examining a tying arrangement challenged in *Jefferson Parish Hospital v. Hyde*, 466 U.S. 2, 104 S.Ct. 1551, 1560, 80 L.Ed.2d 2 (1984), the Court explained that "application of the per se rule focuses on the probability of anticompetitive consequences." The Court further stated that where, as in the instant case, "a purchaser is 'forced' to buy a product he would not otherwise have bought even from another seller in the tied product market, there can be no adverse impact on competition.... Without a showing of actual adverse effect on competition, [plaintiff] cannot make out a case under the antitrust laws...." *Id.*, 104 S.Ct. at 1560, 1568. It appears the rule of *Coniglio* has been strengthened.

Finally, the plaintiff claims in his brief that the defendant acquired its franchises in Harrison and Port Chester through misrepresentation and fraud. This issue is not advanced in the complaint; nor is it a claim for which relief lies under the federal antitrust laws.

Because of the absence of any possible anti-competitive effects, the tie defendant imposes between its provision of Premium channels and Super-Cable is not illegal under the Sherman Antitrust Act. Neither is it an abuse of defendant's monopoly power. Accordingly, defendant's motion for summary judgment is granted.

SO ORDERED.

Senator **Metzenbaum**. Thank you, Mr. Theroux. Let me ask you, have you tried to get HBO programming? You now carry Showtime. Why do you need HBO?

Mr. **Theroux**. We have Showtime as a result of a lawsuit, Senator. Other wireless cable operators like mine do not have Showtime and do not have HBO either. So that is obviously a death knell altogether.

But my problem is that——

Senator **Metzenbaum**. Why can you not get HBO?

Mr. **Theroux**. HBO just will not do business with us. They just say no.

Senator **Metzenbaum**. Have they told you any conditions? They told me that it is a problem of collecting the bills and some of the wireless operators are not that collectable, responsible. Is that a fact?

Mr. **Theroux**. Wireless cable is a brandnew technology. It has never existed in the past. We do not have a history of not paying our bills because we are a new company and a new technology. Now they may want to try to compare us to other businesses, but we are new.

Senator **Metzenbaum**. Are there other kinds of programming that you have tried unsuccessfully to purchase?

Mr. **Theroux**. Disney, the USA Network, the Weather Channel, the Fashion Channel. Other wireless——

Senator **Metzenbaum**. They all turned you down?

Mr. **Theroux**. Other wireless cable operators who did not get going as soon as I did cannot get CNN, they cannot get ESPN. The list is really endless. And again, without the milk and eggs, there is no way that we can provide consumers with a competitive choice.

Senator **Metzenbaum**. ESPN is owned by ABC. Have you tried to get it?

Mr. **Theroux**. My particular company was able to get ESPN although we have certain restrictions imposed upon us that I am not at liberty to divulge, because the restrictions are part of a confidential contract. But we are restricted, unlike the cable operators.

Senator **Metzenbaum**. Are there any restrictions on your ability to delivery Showtime?

Mr. **Theroux**. Yes, we have severe restrictions there. But again, I cannot discuss them because the restrictions are contractual. So without Showtime available in an unrestricted way, we are in a fix. And who gets stuck? It is the consumer.

Senator **Metzenbaum**. Why can you not discuss them because they are contractual?

Mr. **Theroux**. My attorneys have advised me that the terms of my contracts are confidential. But you, Senator, have asked me to divulge the nature of these restrictions?

Senator **Metzenbaum**. Yes.

Mr. **Theroux**. Showtime will not let me sell their service in a number of Cleveland suburbs.

Senator **Metzenbaum**. I see. Senator Humphrey, any questions?

Senator **Humphrey**. No.

Senator **Metzenbaum**. Thank you very much, Mr. Theroux.

Mr. Foster, I am going to have to say to you that the first two witnesses did not seem to understand that 5 minutes was 5 minutes and each of them fudged a bit—some a little bit more than others. Please try to—I will give you a 1-minute notice, all of the witnesses, so you will know you have got one minute left to go.

### STATEMENT OF MARK FOSTER

Mr. **Foster**. Thank you, Mr. Chairman, good morning.

Senator **Metzenbaum**. The only reason I am doing this is because we have so many witnesses and I do not want to keep any of them from having an opportunity to be heard because the time has run out. Please proceed.

Mr. **Foster**. Thank you, Mr. Chairman. Good morning, Senator Humphrey. My name is Mark Foster. I am chairman of Microband, the largest wireless cable company in the Nation. We have about 130,000 subscribers on single-channel systems in New York, Detroit, and Washington. New York and Detroit are now in the multichannel mode and Washington will be shortly. Our company was financed last year with a $72 million financing to help establish the business.

The 1984 Cable Act deregulated the cable industry on the assumption that marketplace competition would replace Government regulation and benefit the consumer. Unfortunately, that competition has yet to fully bloom. Today cable subscribers are far worse off than in 1984, suffering price increases, deteriorating services, and capricious programming decisions. Cable now unrestrained has flexed its economic muscle to prevent wireless cable and other technologies from competing on fair and equal terms.

Exactly what is wireless cable? Simply stated, it is cable television. It is cable television without digging up the streets for wires. To the public, it is cable TV.

One basic fact is obvious; people buy programs, not technology. It is what is on the screen that counts, not how it gets there. Our evolution has been similar to cable's itself. As cable evolved from its start as merely a relay mechanism for distant broadcast signals, undercapitalized CATV promoters were replaced with sophisticated businessmen. Poor quality distribution improved and signal theft was corrected.

Wireless cable has followed a similar path from its genesis in MDS. Its early promoters have been replaced with stable, financially sound companies like Microband. Old transmission and reception equipment has been discarded for state of the art. A new generation of secure, addressable technology eliminates piracy.

Today's wireless cable gives the consumer a choice of all local TV channels, VHF and UHF, combined with satellite-delivered name brand channels that are transmitted via SHF, or super high frequency channels. And most important, wireless cable is lower priced than coaxial cable.

All this sounds great, does it not? Except, our efforts to serve the public have been constantly hampered by the cable MSO's, who view us as a threat which must be eliminated. First they tried to stop us by preempting the early MDS business. Then they opposed licensing of the super high frequency channels. Now they attack our Achilles heel by pressuring the name brand services to withhold necessary programming from us.

Vertical integration and horizontal concentration are the coaxial cable corporate philosophies. Many name brand programmers are now owned by large MSO's. The few independent suppliers all know the enormous market power of the MSO's and they know they can curry favor with those MSO's by refusing to deal with us on fair and equal terms.

Yet, how insidious is this practice? Although Microband has enough programs to go into business, many name brand services appear to have retained the same antitrust lawyer, who told them to stall and stall and stall. For example, the Disney channel claims they have been considering selling to us each quarter for the past 2 years, but so far all we hear are "goofy" answers.

We were successful in obtaining the rights to Black Entertainment Television in New York and Detroit, but here in the Nation's capital, we were denied the service. Why? Because BET is controlled by the local cable company.

In Detroit, we cannot obtain direct affiliation with the popular sports service called PASS. Why? Because exclusive rights have been granted to the cable company. And even if that service should become available, we will have to pay a substantial premium.

In New York, the Yanks and Mets fans will not be able to see SportsChannel this summer because SportsChannel will not sell to us except at an outlandish rate which we cannot pass through to the subscribers.

When we do get programming, it is often under restrictive conditions that bar us from serving those areas already wired for cable.

Mr. Chairman, we need the subcommittee's help. We need legislation to stop the practices which prevent so many millions of people from seeing the brand name cable programming their friends and relatives see. The big bully cannot be allowed to block the little fellow who is trying to serve the unserved. Our society encourages the underdog. Let us compete.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Foster follows:]

# TESTIMONY OF MARK FOSTER
CHAIRMAN AND CO-CHIEF EXECUTIVE OFFICER
THE MICROBAND COMPANIES INCORPORATED
BEFORE THE
UNITED STATES SENATE
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS
MARCH 17, 1988

Mr. Chairman, members of the Subcommittee, on behalf of The Microband Companies Incorporated ("Microband"), I would like to thank you for affording me this opportunity to appear before you today. Although executives of Microband have frequently testified before committees and subcommittees of both houses of Congress, this is our first opportunity to appear before your Subcommittee. I certainly hope that with today's testimony and in the future Microband will be able to provide constructive information in aid of your continuing efforts to monitor and improve the competitive workings of the communications marketplace.

My company is the nation's largest wireless cable operator. Microband today provides a single channel of pay television programming to approximately 135,000 subscribers in the New York, Detroit and Washington metropolitan areas. Recently, Microband has been able to expand its service offerings in New York and Detroit into multiple channel wireless cable systems, and plans on expanding its Washington system shortly. Microband has recently concluded a $72,000,000.00 financing to help fuel this expansion.

Simply stated, wireless cable _is_ cable; except that over-the-air frequencies deliver the full complement of broadcast and satellite-delivered program services to our subscribers.[1] Using our state-of-the-art technology, we can deliver our service more rapidly than cable, at a lower cost than cable, with better signal quality than cable, and with greater security than cable.

At today's hearing, the Subcommittee is investigating the workings of the marketplace for the retail marketing of satellite-distributed video programming services. This is a marketplace that has seen phenomenal change since the coaxial cable industry was largely deregulated two years ago as a result of the Cable Communications Policy Act of 1984. I am sorry to report that the public is not yet enjoying the benefits that the coaxial cable industry promised would flow from the 1984 Cable Act. Indeed, the public is far worse off today than it had been prior to the Act. Congress unleashed the coaxial cable operators in the expectation that marketplace competition would replace government regulation. But Congress did not foresee what has actually happened; the large coaxial cable operators have attempted to frustrate the development of competitive alternatives.

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1/ This Subcommittee may be hearing today about the difficulties many broadcast stations have had in securing carriage on coaxial cable systems. Coaxial cable systems all over the country that suffer from limited channel capacity are dropping broadcast stations in favor of other services. Wireless cable systems have no incentive to engage in such conduct. Because we pick broadcast stations up directly at the rooftop, and do use our scarce SHF channels for retransmission, we have nothing to gain by not passing an available broadcast signal to our subscribers. Regardless of what ultimately happens to the FCC's must carry rules, Microband's policy is one of "will carry"; if the broadcaster provides a VHF or UHF signal to the rooftop, we will carry it through our cable to our subscribers.

In addition, unlike many coaxial cable systems, Microband's wireless cable systems will carry all VHF and UHF stations on their assigned channels. In other words, a Microband subscriber in New York desiring to watch the broadcast station that transmits over VHF Channel 2, WCBS-TV, will tune to Channel 2 on our channel selector box. Our system has been designed so that the channels below 70 are reserved for the VHF and UHF stations, while the satellite services we market will appear on channels 70 through 99.

For some time now Congress, the Federal Communications Commission, the National Telecommunications and Information Administration and other regulatory bodies have been receiving thousands of complaints from retailers to home satellite earth station owners and from satellite master television antenna operators about their inability to secure the rights to market the various name-brand programming services the public wants on terms that are fair and reasonable. Unfortunately, Microband must today add its name to the growing list of companies unable to compete at the retail level on fair and equal terms.

My testimony today will focus on the hurdles Microband must leap to compete with coaxial cable operators in the marketing of satellite-distributed video programming to the public. Microband has a unique perspective on this marketplace as a result of its seventeen years in the field and its status as the largest of the wireless cable operators. I hope that by sharing that perspective with you, Microband can cast a bright light on the practices that have prevented Microband and others in our wireless cable industry from fully and fairly competing with coaxial cable systems in the retail marketing of the name-brand video programming services which the public is anxious to obtain.

Since today's hearing marks the first time that wireless cable system operators have appeared before this Subcommittee, it may be helpful if I digress for a moment to describe with greater detail how a wireless cable system functions, and how the industry developed.

My guess is that when some of you first heard the phrase "wireless cable", you viewed it as an oxymoron. I can assure you it is not. Rather, wireless cable operators combine both wireless, over-the-air technology and coaxial cable technology to provide a service that is virtually indistinguishable by the consumer from an old-fashioned wired cable service.

Again a wireless cable system is a cable system, except that it has eliminated the costly network of wiring that old-fashioned cable systems string or bury between their head-ends and subscribers' homes. Instead, a wireless cable system uses the Super High Frequency ("SHF") portion of the radio frequency spectrum -- above the VHF and UHF bands which are allocated for standard commercial television -- to transmit satellite programming services from a central transmission point directly to a special antenna mounted on the subscriber's rooftop. At the rooftop, the SHF signals are coupled with the locally available VHF and UHF signals and relayed by coaxial cable to a 100 channel selector box atop the subscriber's television set, which box permits the subscriber to conveniently select from among the combined offering of local broadcast signals and satellite program service, the same as he would were he subscribing to a coaxial cable system. A diagram of a typical wireless cable system is attached as Exhibit A.

While the service we provide is virtually indistinguishable from that of an old-fashioned wired cable system, we do offer subscribers significant advantages. Most importantly to those who today have no access to a coaxial cable, wireless cable is available today. By eliminating the time consuming process of burying wires below the streets or stringing wires from telephone poles, wireless cable operators can rapidly bring service to the market.

Wireless cable can be delivered at a lower cost than coaxial cable. The fixed capital costs associated with constructing coaxial cable systems in urban areas are generally high, reflecting the need for extensive underground wiring.

difficulties encountered in hanging cable from congested utility poles, start-up losses arising from financing costs over an extended construction period during which no revenues are generated, and other factors.

For the type of coaxial systems contemplated for the markets which Microband intends to serve, it is estimated that the fixed capital costs, including start-up losses, are no less than $300 per home passed. Furthermore, experience in urban cable systems has shown that penetration rates -- the ratio of subscribers to homes passed -- are significantly lower in urban areas than in rural and suburban areas. At a 25% penetration rate, an initial fixed capital cost of $300 per dwelling passed translates into an average fixed capital cost of $1,200 per subscriber. Coupled with a variable capital cost estimated at about $200 per subscriber (for the converter box and installation), the total coaxial cable capital cost of about $1,400 per subscriber is four to five times that of wireless cable.

Wireless cable operators deliver a signal as good, if not better, than that provided by today's coaxial cable systems. And, our state-of-the-art Zenith scrambling and addressing system gives us better signal security than coaxial cable. To quote the General Electric Company:

> [Wireless cable] performance can meet and even exceed cable in fundamental performance areas like received signal level, carrier-to-noise ratio and nonlinear distortion products. Also, [wireless cable] equipment can provide all of the bells and whistles of a cable system like addressability, scrambling and stereo broadcasts. Combining comparable features and improved performance can make

> [wireless cable] . . . a very competitive alternative.[2]

Cable television had its origins as community antenna television, or CATV, in the 1950's, when small coaxial cable systems were constructed in rural areas where VHF and UHF broadcast signals were too weak for standard residential television antennas to provide good reception. For the first two decades of cable television, coaxial systems were little more than relays for television broadcast signals. By the early-1970's, however, the very nature of coaxial cable service changed. During that period, Home Box Office ("HBO") became the first of the specialized non-broadcast programming services, and drove a demand for coaxial cable service even in urban and suburban regions where viewers already had adequate reception of the broadcast channels, and thus, previously, had no need for cable.

Wireless cable had its origins as the Multipoint Distribution Service, or MDS, in the early-1970's. In those days, wireless cable systems were effectively limited to a single channel in the SHF band. Although these systems were limited to a single channel, they were able to forge market niches in these urban and suburban areas by delivering all that many consumers really wanted, HBO or a similar movie service to supplement the readily available VHF and UHF signals.[3]

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2/ Attached as Exhibit B to this testimony is the report, "Wireless or Wired Cable: Comparable Technologies?", prepared by the General Electric Company from which this quote is taken. This report describes in detail the technical benefits of wireless cable.

3/ In papers submitted to the FCC, Microband has demonstrated that several coaxial cable operators warehoused the single SHF channel available prior to 1983 in areas where they were, or hoped to be, the coaxial cable franchisee. As a result, the development of competitive wireless cable systems was preempted in many markets.

By the late-1970's, however, numerous other satellite-delivered programming services began to gain name-brand recognition from the public, and became de rigueur for wired cable systems. Microband recognized that wireless cable could continue to provide a serious alternative to coaxial cable in urban areas, but only if it could provide its subscribers with the name-brand programming services that were becoming synonymous with the term "cable". In order to deliver those services, more SHF channels were necessary.

Acting on proposals by Microband and others, in 1983 the FCC dramatically altered its rules and policies to make multiple channel wireless cable a possibility. As a result of these rulemakings, up to 33 SHF channels are now available in each major market for use by wireless cable operators, supplementing the locally available VHF and UHF channels.

If the Subcommittee comes away from today's hearing with nothing else, Microband hopes that it will come away with an appreciation that, to the consumer, wireless cable systems, coaxial cable systems, home earth stations and satellite master antenna systems are all in the same product market -- the retail distribution of satellite programming services. Subscribers buy programming; not technology.[4] Our experience in the marketplace confirms that so long as a retailer can provide the diversity of popular programming the public wants, and can provide that programming at a fair price and with a high quality of customer service, that retailer will achieve a market niche, regardless of how its programming is delivered.

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[4] Note one critical difference between wireless cable and coaxial cable systems. Because we do not retransmit local broadcast signals, but instead pick them up at the subscriber's rooftop, we view ourselves as complementary to, and not competitive with, the broadcast industry.

In short, so long as wireless cable operators such as Microband have the name-brand programming the public demands, we can provide a service the public wants, when the public wants it, with a signal quality equal to, if not better than, that of coaxial cable, at prices that are below those charged by coaxial cable operators. With that in our favor, only an inability to acquire the name-brand programming we need on fair and reasonable terms can stop wireless cable from serving as a viable alternative to the coaxial cable industry.

To be sure, the marketplace for the retail distribution of name-brand programming is today dominated by the coaxial cable television industry. Indeed, this dominance is so great that it severely hampers the ability of new entrants to gain a foothold.

The problem we face, simply stated, is that a few large multiple system owners ("MSOs") now wield enormous power over the program suppliers or are themselves the program suppliers. Mergermania has struck the coaxial cable industry like virtually no other sector of American business. The big get bigger, and bigger, and bigger. Just last week, it was announced that United Artists Communications, Inc. and United Cable Television Corp. will be merging to create the nation's third largest MSO, and that the new company will be owned in part by Tele-Communications, Inc., the nation's largest MSO. Simply because these mega-MSOs control the sole video pipeline into the homes of so many, one or two of them can sign the death warrant for a satellite program service merely by refusing to carry it on their systems.

Not only do these mega-MSOs have the power to destroy a program service, but they can exercise that power at little or no cost. At the present time, there is a plethora of satellite-delivered program services, but a dearth of channel capacity on most systems. As a result, most cable systems are free to replace program services at will, as there is always a substitute waiting in the wings. Indeed, things have gotten so bad that, according to Broadcasting magazine's November 23, 1987 issue, "in the past 18 months, cable operator ownership and equity participation -- the footsoldiers of vertical integration -- have rapidly become the quid pro quo for launching new services."[5]

I believe that Microband's inability to secure programming from certain suppliers on equitable terms is a direct result of the horizontal concentration and the vertical integration of the coaxial cable industry. Many of the name-brand program suppliers are now owned by the mega-MSOs. And, the few remaining independent program suppliers all know the enormous power the mega-MSOs have, and they all know that they can curry favor with those mega-MSOs by refusing to deal with competitive wireless cable operators.

For Microband's wireless cable systems to succeed, Microband must have access on fair and reasonable terms to the name-brand program services demanded by the public. It cannot be repeated often enough that consumers buy programming; it is the essence of the marketplace in which we compete. Without the name-brand programming, we simply cannot compete with coaxial cable systems.

Obtaining that name-brand programming has been far from easy. Microband has been refused access to certain programming, has been offered other programming only at prices and on terms so onerous as to make the offer tantamount to no offer at all, and

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5/ A copy of the article from which this quote is taken, and which describes in more detail the growing vertical integration of the cable industry, is attached as Exhibit C.

has had to accept some programming under conditions that unreasonably discriminate against wireless cable.

Mr. Chairman, the Subcommittee will hear today from the Wireless Cable Association about the difficulties its members are encountering in securing any rights to market popular programming services. Therefore, I will keep my comments on that point brief. Although Microband has made some headway, even today many of the most popular programming services, including Showtime, The Movie Channel, The Disney Channel, Cinemax, Festival, The Discovery Channel, USA Network, Bravo, American Movie Classics, Lifetime, Cable Value Network and The Arts & Entertainment Channel still refuse to authorize us to retail their products.

Somehow I get the feeling that these program suppliers all have the same antitrust lawyer counseling them. By and large, they never outright refuse to sell to us; rather, they continually stall. I've lost count of how many times a program supplier has advised Microband that it is "reconsidering" its policy regarding sales to the wireless cable industry. They reconsider, and reconsider, and reconsider. But, they never decide to sell.

Based on our discussions with these programmers and with the program services that ultimately have entered into relationships with Microband, we believe that these refusals to deal are the result of express or implied pressures exerted by coaxial cable operators that are either large customers or owners of the programming services.

Microband's experience with the Black Entertainment Network ("BET") represents a typical absurd example of anticompetitive conduct. After much effort, Microband has secured the right to market BET in Detroit and in New York. However, Microband has been refused permission to retail BET in Washington! That may sound a bit odd, until I add one more piece to the puzzle; those who control the Washington coaxial cable franchisee also control BET. BET has refused to explain why it will not allow Microband's wireless cable system in Washington to carry BET. That is not surprising. There simply is no valid excuse for depriving the residents of the nation's capital access to BET through wireless cable, especially since coaxial cable has barely penetrated the city.

Our experiences with the Turner Broadcasting System are equally illustrative of the effect that cable investment can have on the programmers. For years, Turner Broadcasting System urged us to carry CNN on our wireless cable systems once we began operations. It is probably no coincidence that, once a consortium of cable operators (no doubt emboldened by the 1984 Cable Act) invested in Turner and began to take an active role in the management of the company, CNN decided it would enter into no new affiliation agreements with wireless cable operators. As a result, our subscribers in New York and Detroit (many of whom are not served by coaxial cable) are being deprived of this unique program service.

As unfortunate as Turner's about-face on CNN has been for the public, the recent news emanating from Atlanta regarding Turner Network Television ("TNT") is even worse. Recent reports indicate that the consortium of cable operators that now controls such decisions for Turner has agreed to permit the launch of a new, satellite-distributed network by Turner. Not surprisingly, that new network will be available only to coaxial cable systems, and not to wireless cable operators.

This announcement is doubly troublesome for Microband, for it suggests that a significant amount of the most popular programming on superstation WTBS will be shifted to TNT. Because WTBS is today distributed by an independent common carrier, it is currently available to Microband and the rest of the wireless cable industry. I have serious doubts that WTBS will be of much interest to our subscribers once the coaxial cable operators who dominate Turner strip WTBS of its most popular fare in order to bolster the cable-only TNT service.

Indeed, there is some doubt in my mind as to how long the wireless cable industry will even have access to WTBS. Just last month, Tele-Communications, Inc., the largest coaxial cable operator in the nation, applied to the Federal Communications Commission for permission to acquire control over the carrier that distributes WTBS to us. Unless the FCC acts to assure our continued access to WTBS, our subscribers may soon lose access to that programming, too.

I mentioned before that I thought most program services used the same antitrust lawyer, one who counsels delay. On second thought, maybe there is a second antitrust lawyer out there, one who advises programmers to make wireless cable operators offers that include such onerous terms and conditions, the offers cannot practically be accepted. Recent events involving our Detroit and New York wireless cable systems are indicative.

One of the most popular types of programming services is the regional sports network. In Detroit, Pro Am Sport Systems ("PASS") has exclusive rights to distribute certain Tigers baseball games, Piston basketball games, and Red Wings hockey games, among others. When Microband recently met with PASS to negotiate an affiliation agreement that would permit us to market that name-brand programming to our subscribers in Detroit (a substantial number of whom have no access to coaxial cable), we were told in no uncertain terms that we would have to purchase those rights from Barden Cablevision, the cable company which holds the Detroit franchise and our competitor. PASS would not sell to us directly. PASS had invited Barden to that meeting, and Barden made it quite clear that we would have to pay more for the program service than Barden does. In addition, Barden insisted upon other onerous terms and conditions. Although PASS has such tremendous marquee value that we may have no choice but to accede to Barden's demands, PASS's refusal to deal, coupled with Barden's control over the programming, is certain to have adverse financial implications for us.

The situation is not much different in New York City, where SportsChannel holds exclusive contracts for the vast majority of the Yankees and Mets baseball games, Islanders hockey games, Nets basketball games and New York Racing Association thoroughbred racing. SportsChannel's parent is a coaxial cable company, Cablevision Systems Corporation, which, through a subsidiary, has the sole coaxial cable franchise for large portions of New York City which Microband also serves. Through this corporate chain, our coaxial cable competitor in the retail market has absolute control over whether Microband can provide residents of the New York metropolitan area (much of which is uncabled) with access to events to which SportsChannel has acquired exclusive rights.

Not surprisingly, SportsChannel will not provide its name-brand programming service to Microband unless we enter into a contract with terms more onerous than those imposed on coaxial cable companies -- terms the coaxial cable companies would be unwilling to agree to if offered. Microband simply cannot accept those terms. As a result, our subscribers are denied access to the exclusive sports programming carried by SportsChannel.

Other programming services refuse to deal with us on a basis which keeps our programming costs competitive with those offered to similarly situated coaxial cable systems. We must pay for Headline News, which is generally available free of charge to coaxial cable systems. The Christian Broadcasting Network has quoted us a rate twice that of its standard cable rates. Coaxial cable systems are given VH-1 at no charge if they carry its sister service, MTV. Microband has been asked to pay for VH-1, even if it carries MTV. And, Microband must pay more for MTV than its coaxial cable competitors. In effect, Microband pays more than double the cost of the MTV/VH-1 package in comparison to the rates charged coaxial cable systems. Our rates for ESPN and BET are also higher than the standard coaxial rates.

Our contract with ESPN also restricts our ability to market that service in certain neighborhoods within our coverage area. ESPN limits our marketing efforts only to residents in specified areas where the local coaxial cable company has not yet constructed any part of its system.

This pattern of protection of coaxial cable companies has a clear anticompetitive effect. We want to market quality programming at competitive prices -- but our coaxial competitors in the retail market appear to control the programmers' product, prices and market area, thereby frustrating our efforts to compete and serve the public.

Mr. Chairman, the public needs your help. Legislative action is essential to assure that wireless cable and other technologies have an opportunity to compete with coaxial cable systems in the marketing of the name-brand programming services.

Last week, the FCC released its final report on the competitive workings of the market for retailing satellite programming to home satellite dish owners. In that report, the FCC concludes that, to the extent problems in the retail marketplace stem from coaxial cable market power, the appropriate solution is to address that market power, rather than to regulate the program suppliers.

In a perfect world, I would agree with that conclusion. Unfortunately, it is far too late in the day for the approach suggested by the Commission. There has already been too much horizontal concentration and vertical integration. The programming services must be regulated because, absent regulation, they are unable to resist the economic power and control the coaxial cable operators exert today.

Should coaxial cable operators be ultimately barred from owning programming services? I think so. Should limits be placed on the number of subscribers a coaxial cable MSO can control? I think so. But it will be quite some time before such restrictions can be imposed, and the necessary divestitures consummated. Until then, the only way in which wireless cable and other alternative technologies can be assured a niche in the existing marketplace is for the Congress to provide a mechanism that guarantees that programmers do not discriminate on the basis of technology.

Since the Cable Communications Policy Act of 1984, coaxial cable subscribers across the country have suffered rate increases, deteriorating service and capricious programming decisions. Of course, those coaxial cable subscribers are lucky, at least compared to the citizens of major urban areas such as Cleveland, Detroit, New York and Washington, who today have no access to many name-brand programming services.

Maybe the time has come to remind the monopolistic cable industry that they were once in our position, of when they fought a broadcast industry which held all the cards. Now that the coaxial cable MSOs are fat and rich, they cannot be allowed to run rough shod over the public interest. It is obvious that the big bully doesn't want us to play on his field.

Competition is good; it is basic to our free enterprise system. The 1984 Act was premised on the development of a competitive retail market for the distribution of programming to the public. Absent legislation that guarantees alternative technologies full and fair access to that programming free from the anti-competitive conduct of coaxial cable, there will be no competitive alternative to coaxial cable. Absent legislation, coaxial cable's stranglehold on the retail market can only tighten.

Thank you.

EXHIBIT A

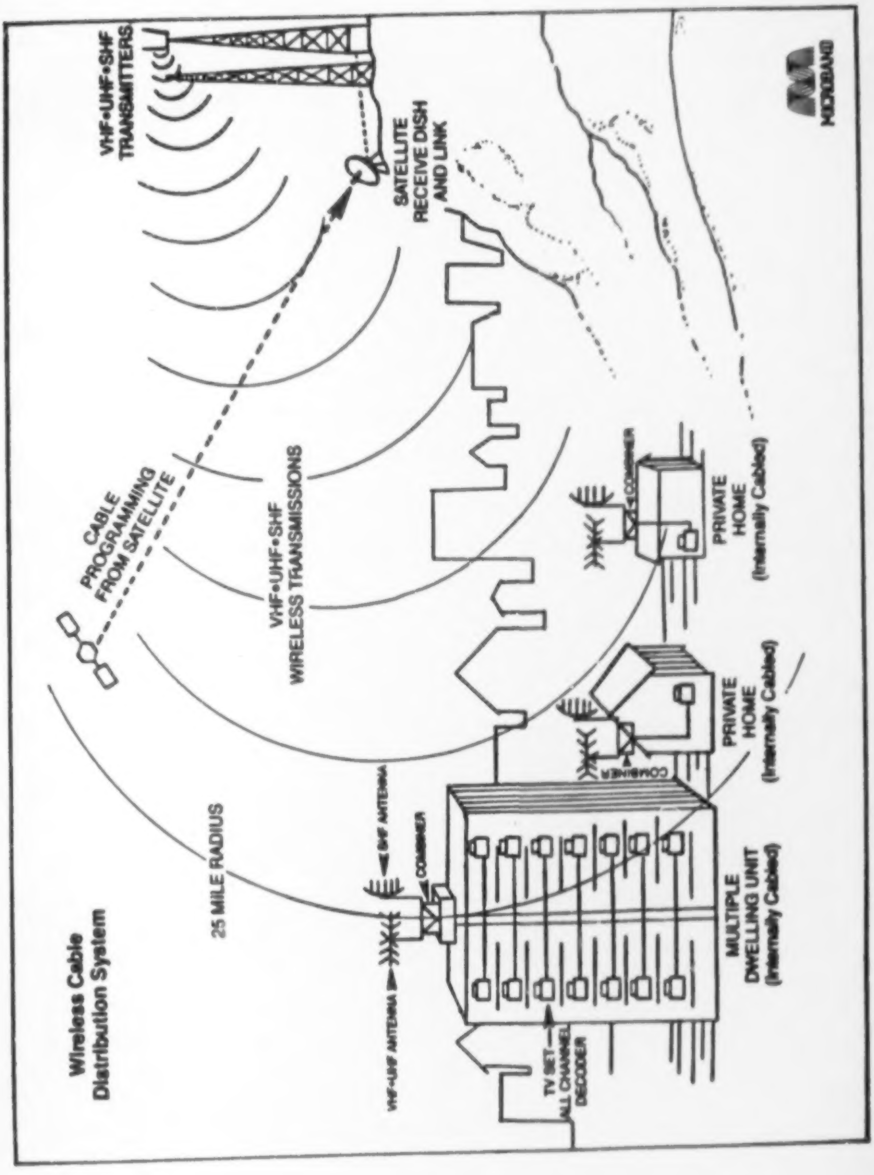

Wireless Cable Distribution System
25 MILE RADIUS
CABLE PROGRAMMING FROM SATELLITE
VHF•UHF•SHF WIRELESS TRANSMISSIONS
VHF•UHF•SHF TRANSMITTERS
SATELLITE RECEIVE DISH AND LINK
VHF•UHF ANTENNA
SHF ANTENNA
COMBINER
TV SET— ALL CHANNEL DECODER
MULTIPLE DWELLING UNIT (Internally Cabled)
COMBINER
PRIVATE HOME (Internally Cabled)
COMBINER
PRIVATE HOME (Internally Cabled)
MICROBAND

EXHIBIT B

# Wireless or Wired Cable: Comparable Technologies?

By George Harter
General Electric
Comband Division

Can the performance of a microwave Multichannel Multipoint Distribution Services (MMDS) meet or exceed cable system performance? The answer is yes. MMDS performance can meet and even exceed cable in fundamental performance areas like received signal level, carrier-to-noise ratio and nonlinear distortion products. Also, MMDS equipment can provide all of the bells and whistles of a cable system like addressability, scrambling and stereo broadcasts. Combining comparable features and improved performance can make MMDS a successful compliment to an existing cable system or a very competitive alternative.

## Performance

To begin, let us define a typical MMDS and cable system as shown in Figure 1. The MMDS system will utilize an omnidirectional transmitting antenna mounted 500 feet above ground level. For simplicity we will assume a constant receive antenna height of 20 feet and a flat earth, realizing the farthest practical receive site distance will be limited to approximately 40 miles by the radio horizon. The detailed characteristics of the transmit and receive site equipment are listed in Table 1.

The cable system design is simple and consists of a series of feedforward trunk amplifiers with a generous 2600' of separation. Each trunk amp breaks off into feeder legs consisting of a bridger amplifier and two line extenders. The performance levels at the output of this second line extender will be compared with the MMDS performance levels at the block downconverter output. The characteristics of each of the amplifiers are listed in Table 2.

Using the systems described above, the C/N was calculated for distances out to 40 miles (80 trunk amplifiers) and is shown in Figure 2. The perturbations in MMDS C/N from .5 to 1.5 miles out is caused by the elevational pattern characteristics of the transmitting antenna. Now, 80 trunk amplifiers may not be practical for cable system operation, but 40 miles of coverage area certainly is practical for MMDS operation. As you can see from Figure 2, the MMDS system C/N with only 10 watts of transmitter output power exceeds the cable system performance out to a distance of approximately 28 miles (57 trunk amplifiers). Increasing the transmitter output power to 20 or 100 watts can potential increase the C/N margin even further.

Figure 2 describes the ideal situation where the C/N is only limited by the signal level received at each receive site. For systems of 2 to 16 channels in size this level of performance is quite practical. However, when the number of channels increases to beyond 16, the downconverter dynamic range will typically limit the maximum allowable received signal level and thus will be the controlling factor for C/N. This is especially true for clear line-of-site receive sites out to distances of 20 to 25 miles from the transmitting antenna.

Likewise, the downconverter dynamic range will usually be the controlling factor for the system nonlinear distortion performance. The architecture of the MMDS transmitting system is optimized for minimum distortion generation. An individual transmitter is used for each channel and channels are combined through the use of passive waveguide combiners. Typical crossmodulation and intermodulation numbers of -60 db are very typical at the output of the transmitting antenna(s). Therefore, the downconverter is the only active element in the system handling the combined power of all channels. Because of this, the downconverter input level must be kept within the specified dynamic range to insure optimum intermodulation and crossmodulation performance (typically -55 to -60 db). This adjustment of received signal level will ultimately affect the C/N ratio.

Cable has a much more severe problem with nonlinear distortions because of the number of active devices handling all of the video channels. Crossmodulation, intermodulation and composite triple beat will worsen through every amplifier. The major contributor to nonlinear distortions in a cable system are the feeder lines containing the bridger amplifiers and line extenders. These amplifiers typically have 20 to 30 db worse distortion figures than the trunk amplifiers. Because our model of a cable system contains only two line extenders and one bridger amplifier per trunk amp, the crossmodulation calculations result in excellent performance for both cable and MMDS. However, unlike MMDS, the potential for distortion products to increase grows as a cable system expands.

## Limitations

As described above, MMDS can have significant performance advantages over cable. However, there are limitations placed on MMDS because it is an over-the-air technology. Because of the frequency of the MMDS transmissions (2.1 to 2.7 GHZ) it is essentially a line-of-site technology. Receive sites with totally or partially obstructed views of the transmitting antenna may have tremendous variations in received signal strength. Receive sites surrounded by foliage may experience large signal level fluctuations as the seasons change. It is essential to insure clear line-of-site between transmit and receive sites in order to obtain consistent performance at all times.

However, these problems with terrain and obstructions can be managed. There are signal strength contour studies available which will predict the amount of loss an MMDS operator can expect from terrain. By combining these studies with intuitive reasoning regarding other structures in the propagation area and foliage, an MMDS operator can predict his coverage area very accurately.

## Other Advantages

Not only can MMDS offer performance advantages over cable, but also increased system reliability. Since there is no closed distribution system, the only equipment concerns are at the transmit site and the subscriber's home. The current design trend for MMDS transmitting equipment is away from tube technology and towards solid state devices. Solid state technology is more reliable and less power consuming.

The receive site antenna and downconverter are designed to reside on the subscriber's roof in a variety of weather conditions with excellent reliability. However, the potential weak link in the receive site installation can be the interconnections from the downconverter to the antenna and into the subscriber's home. Care must be taken to insure all connections are sealed and weather tight. The ingress of moisture into these interconnections can have considerable impact on received signal quality.

Another significant advantage to MMDS is the speed at which a system can be built. Once the construction of the system begins, it is not unusual to be ready to install subscribers 1 to 3 months afterwards. This is significantly better than the typical start-up times for a cable system.

## Bells and Whistles

Currently available MMDS equipment also offers all of the operational features of cable systems and then some. Signal security, addressability, stereo compatibility and spectrum space for ancillary data services are all available in MMDS.

Security wise, both audio and video scrambling techniques are available. Current techniques consist of video inversion, sync suppression, bandwidth compression and combinations of these.

Addressability is performed through the use of in-band data transmission. Current techniques involve transmission in either the video or audio paths. Along with addressability come features like pay-per-view capability, flexible tiering and combining of programming, channel mapping and increased deterrents to pirating of signals and converters.

Since most MMDS equipment is designed to handle the additional audio bandwidth for BTSC stereo, the system is stereo transparent from the beginning. With the addition of stereo encoders at the transmitter site and decoders in the home, subscribers can enjoy excellent quality stereo sound.

## Conclusions

A well designed and well managed MMDS system can exceed cable system performance in the fundamental areas which significantly impact subscriber satisfaction. Through careful and detailed system design, MMDS can achieve an excellent reputation as a high quality and high performance broadcast service. Also, since MMDS operators do not have an expensive distribution system to maintain, more attention can be paid to customer service and satisfaction. However, it is important for an MMDS operator to understand the technical capabilities and limitations of his system. With this understanding, an MMDS operator can build a successful and profitable business.

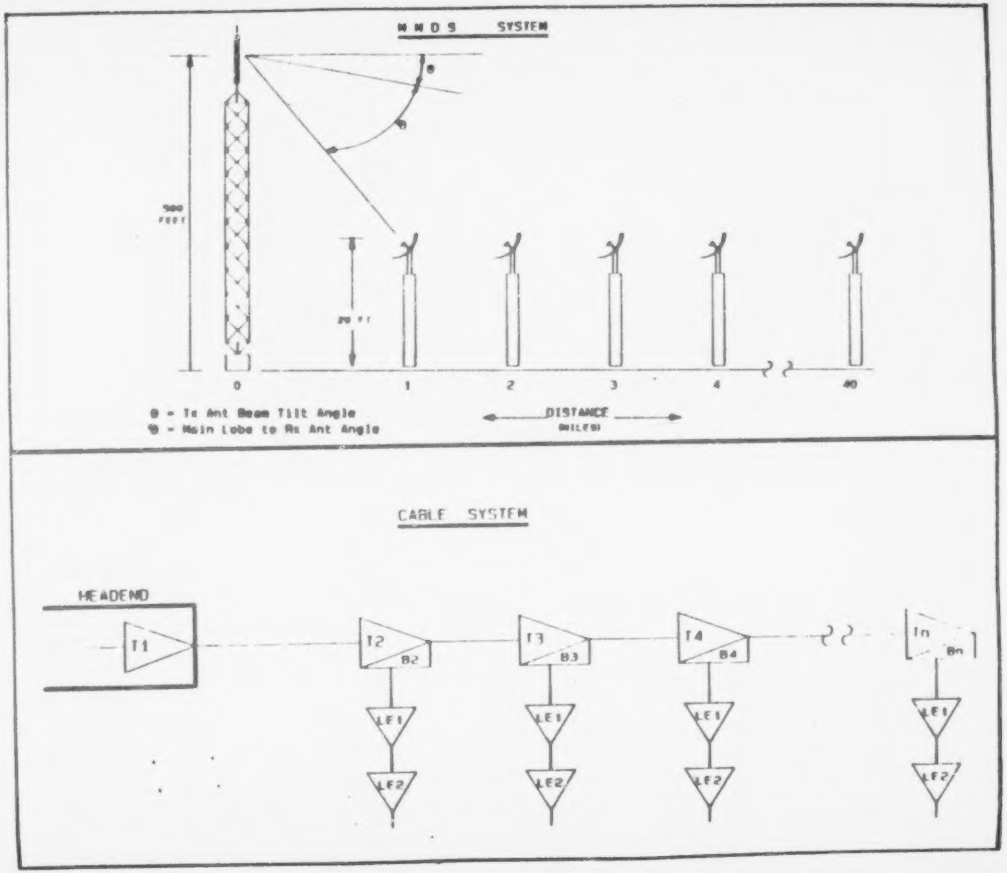

MMDS SYSTEM
500 FEET
20 FT
0
1
2
3
4
40
θ = Tx Ant Beam Tilt Angle
φ = Main Lobe to Rx Ant Angle
DISTANCE
(MILES)
CABLE SYSTEM
HEADEND
T1
T2
B2
T3
B3
T4
B4
Tn
Bn
LE1
LE2

Figure 1. MMDS and cable system architectures.

Freq (GHz) = 2.6
Tx Pwr (watts) = 10
Combining Losses (db) = 3
Tx Ant Gain (dbi) = 13
Rx Ant Gain (dbi) = 21
BDC Gain (db) = 20
Rx Ant TE (Kelvin) = 150
BDC NF (db) = 5.00
Tx Ant Height (ft) = 500
Tx Ant Tilt (degrees) = 0.5
Typ Rx Ant Height (ft) = 20

| Distance (miles) | Path Loss (db) | Rx Level (dbm) | C/N (db) | Tx/Rx Ant Angle (degrees) | Elevation Pattern Attn (db) |
|---|---|---|---|---|---|
| 0.5 | 98.88 | -28.88 | 55.69 | -9.80 | -21 |
| 0.75 | 102.40 | -26.90 | 57.67 | -6.41 | -15.5 |
| 1 | 104.90 | -30.40 | 54.17 | -4.69 | -16.5 |
| 1.5 | 108.42 | -21.22 | 63.35 | -2.97 | -3.8 |
| 2 | 110.92 | -21.42 | 63.15 | -2.10 | -1.5 |
| 3 | 114.44 | -23.94 | 60.63 | -1.24 | -0.5 |
| 4 | 116.94 | -26.19 | 58.38 | -0.80 | -0.25 |
| 5 | 118.88 | -28.13 | 56.44 | -0.54 | -0.25 |
| 6 | 120.46 | -29.46 | 55.11 | -0.37 | 0 |
| 7 | 121.80 | -30.80 | 53.77 | -0.24 | 0 |
| 8 | 122.96 | -31.96 | 52.61 | -0.15 | 0 |
| 9 | 123.98 | -32.98 | 51.59 | -0.08 | 0 |
| 10 | 124.90 | -33.90 | 50.67 | -0.02 | 0 |
| 15 | 128.42 | -37.42 | 47.15 | 0.15 | 0 |
| 20 | 130.92 | -39.92 | 44.65 | 0.24 | 0 |
| 25 | 132.86 | -41.86 | 42.71 | 0.29 | 0 |
| 30 | 134.44 | -43.44 | 41.13 | 0.33 | 0 |
| 35 | 135.78 | -44.78 | 39.79 | 0.35 | 0 |
| 40 | 136.94 | -45.94 | 38.63 | 0.37 | 0 |
| 45 | 137.96 | -46.96 | 37.61 | 0.38 | 0 |
| 50 | 138.88 | -47.88 | 36.69 | 0.40 | 0 |

Table 1. MMDS system characteristics used in analysis.

| Trunk Amp # | Distance (miles) | Trunk Amp C/N | Line Ext C/N |
|---|---|---|---|
| 1 | 0.49 | 59.10 | 54.49 |
| 2 | 0.98 | 56.09 | 53.20 |
| 3 | 1.48 | 54.33 | 52.20 |
| 4 | 1.97 | 53.08 | 51.40 |
| 5 | 2.46 | 52.11 | 50.72 |
| 6 | 2.95 | 51.32 | 50.13 |
| 7 | 3.45 | 50.65 | 49.61 |
| 8 | 3.94 | 50.07 | 49.15 |
| 9 | 4.43 | 49.56 | 48.73 |
| 10 | 4.92 | 49.10 | 48.35 |
| 15 | 7.39 | 47.34 | 46.82 |
| 20 | 9.85 | 46.09 | 45.70 |
| 25 | 12.31 | 45.12 | 44.80 |
| 30 | 14.77 | 44.33 | 44.06 |
| 35 | 17.23 | 43.66 | 43.43 |
| 40 | 19.70 | 43.08 | 42.88 |
| 50 | 24.62 | 42.11 | 41.95 |
| 60 | 29.55 | 41.32 | 41.18 |
| 70 | 34.47 | 40.65 | 40.53 |
| 80 | 39.39 | 40.07 | 39.97 |

Trunk Amp :
Gain = 26.00
NF = 10.00
C/N = 59.1

Bridger Amp :
Gain = 31.00
NF = 9.50
C/N = 59.60

Line Ext :
Gain = 30.00
NF = 8.00
C/N = 62.1

Table 2. Cable system characteristics used in analysis.

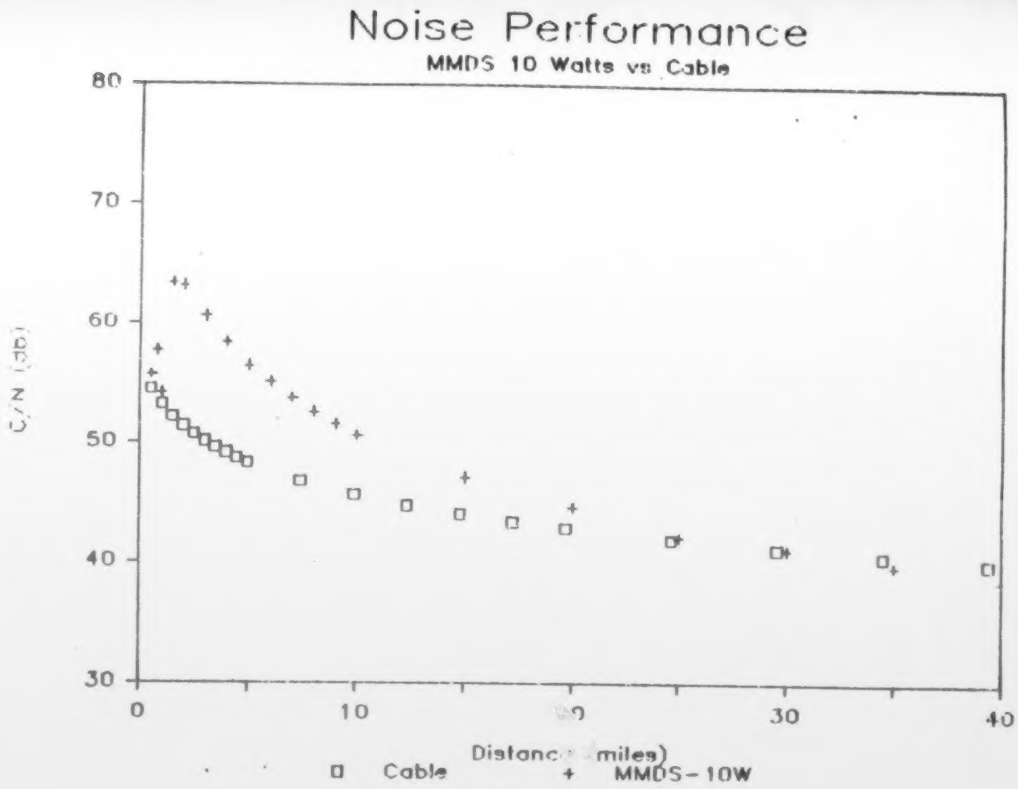
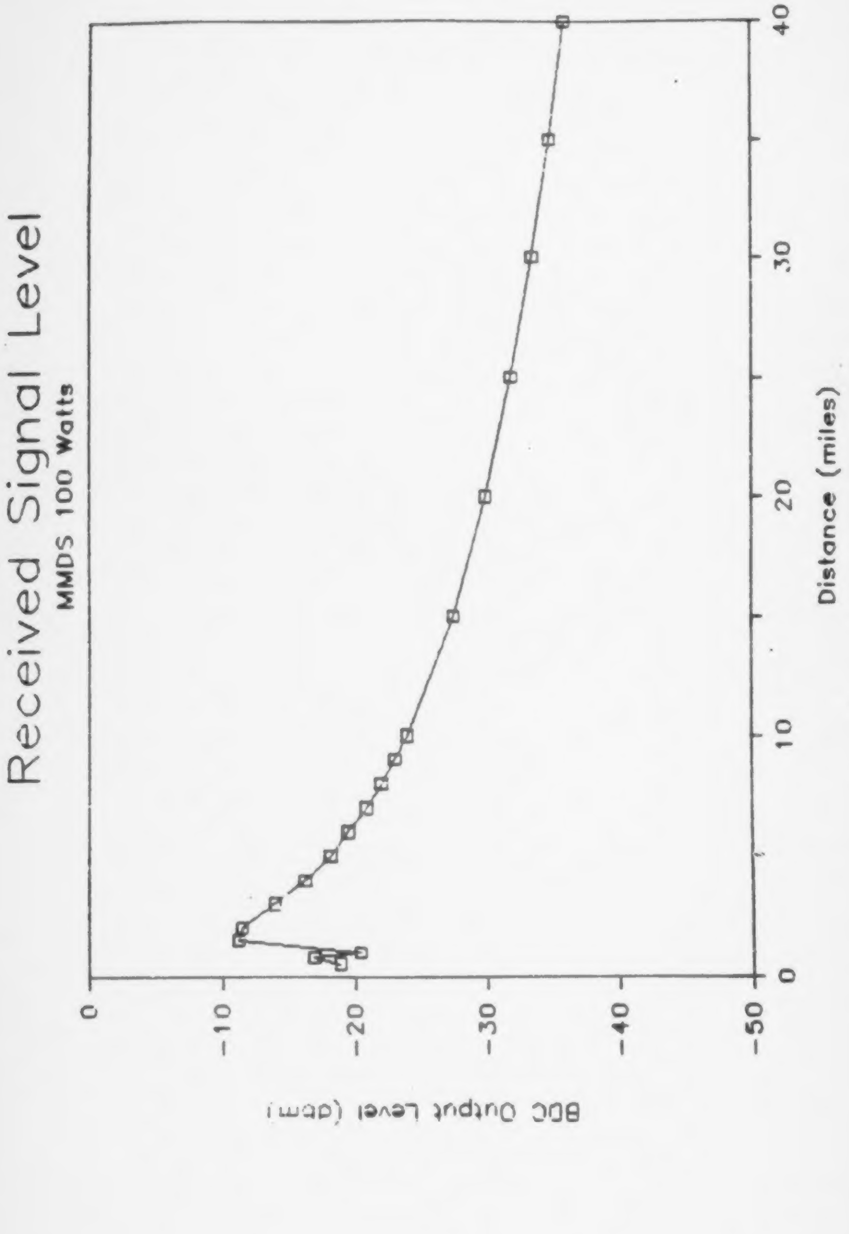
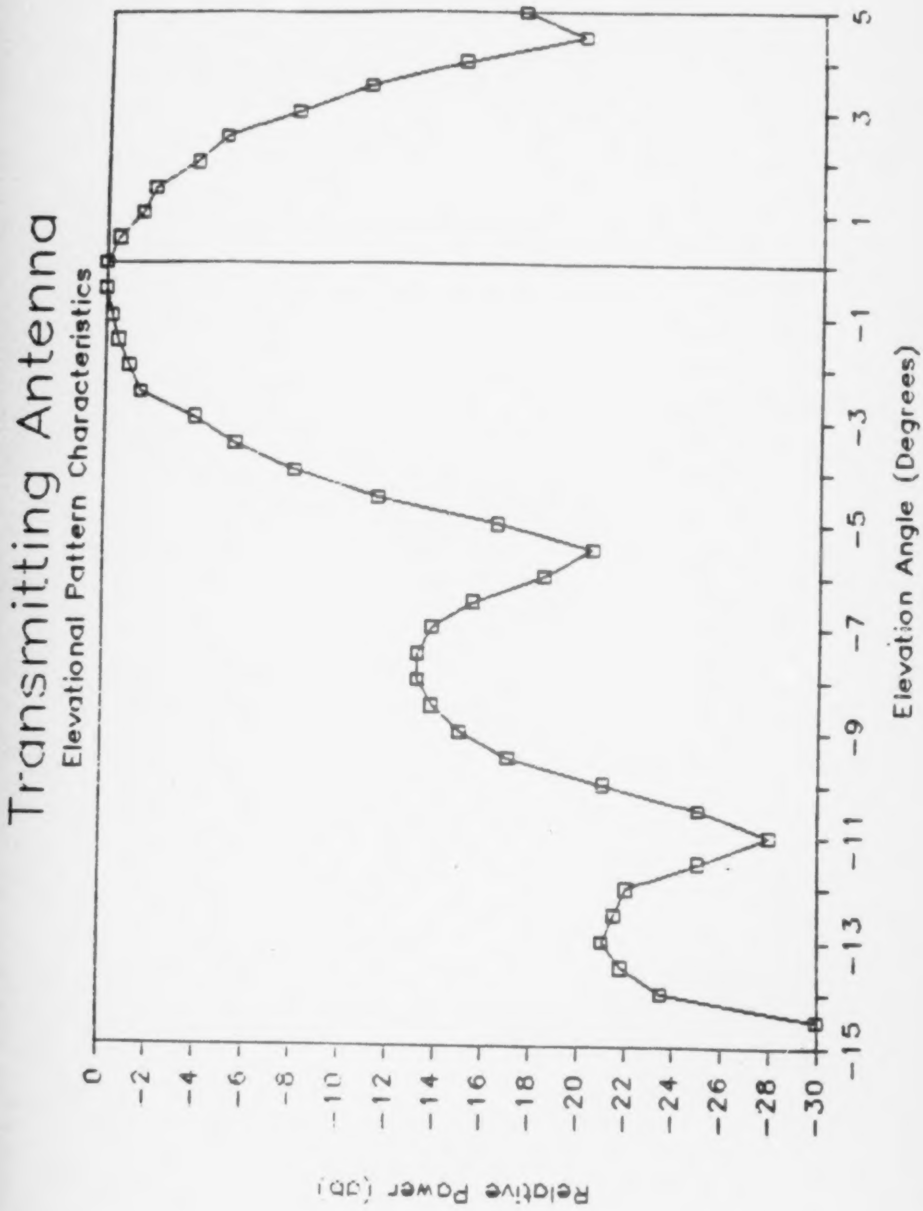


Figure 2. 10 watt MMDS versus cable carrier-to-noise performance.

Appendix A.
MMDS received signal level at 10 and 100 watts of transmitter power.



Appendix B.
Transmitting antenna elevational pattern characteristics.



## Appendix C.
## MMDS performance with 100 watts of transmitter power.

Freq (GHz) = 2.6
Tx Pwr (watts) = 100
Combining Losses (db) = 3
Tx Ant Gain (dbi) = 13
Rx Ant Gain (dbi) = 21
BDC Gain (db) = 20
Rx Ant TE (Kelvin) = 150
BDC NF (db) = 5.00
Tx Ant Height (ft) = 500
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|---|---|---|---|---|---|
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| 0.75 | 102.40 | -16.90 | 67.67 | -6.41 | -15.5 |
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| 1.5 | 108.42 | -11.22 | 73.35 | -2.97 | -3.8 |
| 2 | 110.92 | -11.42 | 73.15 | -2.10 | -1.5 |
| 3 | 114.44 | -13.94 | 70.63 | -1.24 | -0.5 |
| 4 | 116.94 | -16.19 | 68.38 | -0.80 | -0.25 |
| 5 | 118.88 | -18.13 | 66.44 | -0.54 | -0.25 |
| 6 | 120.46 | -19.46 | 65.11 | -0.37 | 0 |
| 7 | 121.80 | -20.80 | 63.77 | -0.24 | 0 |
| 8 | 122.96 | -21.96 | 62.61 | -0.15 | 0 |
| 9 | 123.98 | -22.98 | 61.59 | -0.08 | 0 |
| 10 | 124.90 | -23.90 | 60.67 | -0.02 | 0 |
| 15 | 128.42 | -27.42 | 57.15 | 0.15 | 0 |
| 20 | 130.92 | -29.92 | 54.65 | 0.24 | 0 |
| 25 | 132.86 | -31.86 | 52.71 | 0.29 | 0 |
| 30 | 134.44 | -33.44 | 51.13 | 0.33 | 0 |
| 35 | 135.78 | -34.78 | 49.79 | 0.35 | 0 |
| 40 | 136.94 | -35.94 | 48.63 | 0.37 | 0 |
| 45 | 137.96 | -36.96 | 47.61 | 0.38 | 0 |
| 50 | 138.88 | -37.88 | 46.69 | 0.40 | 0 |

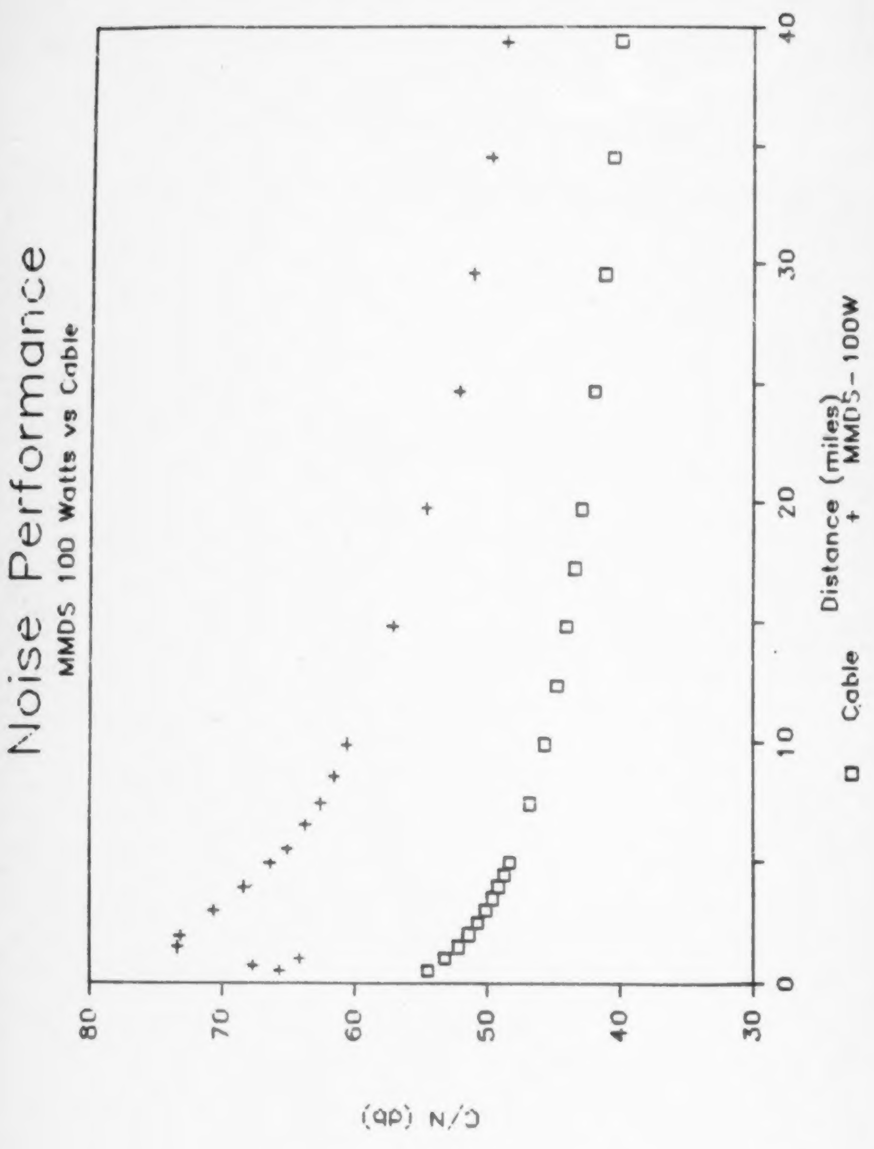
Noise Performance
MMDS 100 Watts vs Cable
C/N (db)
80
70
60
50
40
30
0
10
20
30
40
Distance (miles)
□ Cable
+ MMDS - 100W

EXHIBIT C

# Vertical Integration

## The business behind the boom in cable programing

*The setting is the Denver office of the chief executive of a major MSO. On the other side of the desk is someone with a "great idea" for a new cable programing service.*

*Programer:...It's a goldmine.*

*CEO: Mmmmm.*

*Programer: Well, we'll give operators an equity interest.*

*CEO: Mmmmm.*

*Programer: OK, we'll give you 51% ownership, but not a dime more.*

*CEO: Mmmmm.*

*Programer: OK, OK, you can have 80%, but I've got to have 20% to meet payroll.*

An exaggeration? Yes. But in the past 18 months, cable operator ownership and equity participation—the foot soldiers of vertical integration—have rapidly become the quid pro quo for launching new services.

There are a number of reasons why this method of financing/distribution has come into vogue. Cable operators see equity participation as a way to insure that services they feel their subscribers want will see the light of day. It gives cable operators greater, or in some cases, total control over the service. As industry proponents call for cable-exclusive programing to differentiate themselves, owning programing services takes on more allure. For many years, and to a lesser extent today, the cable industry has been criticized for relying on warmed over network or syndication reruns. Flush with cash from the completion of most system construction, and freed from local rate regulation, cable operators have the money to plow back into programing. And they are using some of that money to take equity stakes in programing services.

But although cable operators look at equity as a way to acquire a wider range of programing, and much that otherwise might not be produced, critics see the same development as an attempt by cable operators to hoard product and an example of an insensitivity to exclusivity arrangements that have helped cable prosper.

Programers who have tried to launch services in the past 18 months have found the shelf space dwindling. Channel capacity is as tight today on cable systems as it was in the early 80's. Although the situation is expected to ease somewhat by the early 1990's, as the last of the major urban builds are finished and system upgrades continue, cable operators are wondering how many more services can be added, since in the end consumers wind up paying for them.

Today's capacity crunch, which threatens to postpone the launch of the one of the industry's most solidly backed services, Turner Broadcasting System's Turner Network Television, is causing potential programers to offer equity stakes to operators to insure carriage. Most of the equity ventures that have launched in the last year and a half have a telemarketing feature, such as the Travel Channel, The Fashion Channel and the QVC Network. But other services have launched, although on a much lower scale, without equity offerings, the Consumer Discount Network and Movietime, for example. You TV and Teleworld are also on the drawing boards for launch next year, but neither came out of the blocks with equity participation ast part of its company structure.

Financial News Network's Meister

Fashion Channel's Herman

ATC's Dressler

"An equity deal is wonderful for initial distribution, and it secures a lot of different fronts," says Sheri Herman, vice president, sale and marketing, Fashion Channel, which launched with 65 equity cable operator partners. "But work still has to be done on a day-to-day basis to make sure it's a working partnership. If you don't have that, the best equity deal in the world won't matter."

David Meister, Financial News Network director, has launched services with and without equity. "In reality, what you have, no matter what the piece of paper between the two entities, is an inherent partnership in the promotion of a cable programing service to the consumer," says Meister. "In that process, a deal is going be made, whether you call it equity, revenue sharing, affiliate fee, commission or whatever. If it isn't a reasonable and fair deal, the whole thing breaks down."

Cable operators, although coming from a different perspective, also find that the equity-carriage element is a very important part, but that aspect alone won't carry a service. Still, some operators are more bullish than others when it comes to ownership or equity participation. Bob Redella, vice president, programing and investments for Cox Cable, lists what's important for getting a new service off the ground: "All the pieces really have to fit. The service has to be quality. It has to have a continuous flow of programing. It has to have good management. It has to have the necessary finances and finally it has to have carriage." Cox has taken a strong position in program service ownership, through the Discovery Channel, Home Premiere Television and its own home shopping service, America's Shopping Club. But the key question in launching a new service, said Redella, whether equity or ownership stakes are involved, is: "Is the programing of quality value for the consumer?"

Taking a bit more cautious approach is American Television & Communications, the second largest MSO. "We are not out looking for equity positions in cable services," said Fred Dressler, vice president of programing. "We understand why people are offering equity, but it's our position that we'd rather make decisions on the value of the product and not the value of the investment."

### While we're on the subject

An extended discussion on the approaches of various MSO's to ownership in program services, and an examination into why programers offer equity in order to gain distribution, continues on page 66. A list of the principal regional sports programing services, many owned by cable MSO's, appears on page 67.

## Who owns what with whom in cable networking

**Basic services**

| *Network* | *Subscribers* | *Ownership* |
|---|---|---|
| ***ESPN*** | 44.300 | Capital Cities/ABC (80%), RJR Nabisco (20%) |
| ***WTBS*** | 41,642 | Turner Broadcasting (Ted Turner 65%, Time Inc **[ATC]** 11.5%, **TCI** 10.1%, **UA** 4.8%, **United** 3.2%, **Warner** 1.8%) |
| ***CNN*** | 41.642 | Turner Broadcasting (Ted Turner 65%, Time Inc **[ATC]** 11.5%, **TCI** 10.1%, **UA** 4.8%, **United** 3.2%, **Warner** 1.8%) |
| ***USA*** | 39.000 | MCA (50%), Paramount (50%) |
| ***MTV*** | 37.100 | MTV Networks Inc **(Viacom)** |
| ***Nashville*** | 36.000 | Gaylord Broadcasting |
| ***CBN*** | 35.834 | Christian Broadcasting Network |
| ***Nickelodeon*** | 35.800 | MTV Networks Inc **(Viacom)** |
| ***Lifetime*** | 32.300 | CC/ABC (33%), **Viacom** (33%), **Hearst** (33%) |
| ***Weather Chan.*** | 31,053 | Landmark Communications (former parent of TeleCable) |
| ***Nick at Nite*** | 31.000 | MTV Networks Inc **(Viacom)** |
| ***Headline News*** | 28.352 | Turner Broadcasting (Ted Turner 65%, Time Inc **[ATC]** 11.5%, **TCI** 10.1%, **UA** 4.8%, **United** 3.2%, **Warner** 1.8%) |
| ***FNN*** | 27.000 | Infotech (20%), Dr Earle Brian (15%) |
| ***A&E*** | 27.000 | CC/ABC (33%), NBC (33%), **Hearst** (33%) |
| ***Discovery*** | 25.600 | **TCI** (14%), **United** (14%), **Cox** (14%), **Group W** (14%), **Newhouse** (14%), management, New York Life Co., Allen & Co (30%) |
| ***C-SPAN*** | 23.000 | **Cable operator supported** |
| ***VH-1*** | 22.900 | MTV Networks Inc **(Viacom)** |
| ***WGN*** | 22.481 | Tribune Broadcasting |
| ***Score*** | 19.800 | Infotech (20%), Dr Earle Brian (15%) |
| ***CVN*** | 19.000 | COMB Co (50%), **18 cable operators*** (50%) |
| ***BET*** | 15.000 | Bob Johnson (51%), BET president, **TCI** (16%), **HBO** (16%), **Taft** (16%) |
| ***HSN I*** | 13.500 | Home Shopping Networks Inc |
| ***C-SPAN II*** | 12.500 | **Cable operator supported** |
| ***Tempo TV*** | 12.500 | **TCI** (pending owner) |
| ***Telshop*** | 11,000 | Infotech (20%), Dr. Earle Brian (15%)** |
| ***QVC Network*** | 10,747 | QVC Network (65%), **Comcast** (14%), **cable operators** (21%)*** |
| ***Inspirational*** | 10.700 | PTL Club |
| ***Learning Chan.*** | 10.300 | Infotech (40%), Appalachian Community Service Network (40%), officers and employes (20%) |
| ***WWOR*** | 10,100 | MCA |
| ***Silent Network*** | 10,100 | Silent Network Inc. |
| ***Video Mall Net.*** | 10.000 | Video Shopping Mall (Goodway Marketing 80%) |
| ***Trinity*** | 7.200 | Trinity Broadcasting Network (nonprofit) |
| ***Eternal Word TV*** | 7.100 | Eternal Word Television (nonprofit) |
| ***Fashion Channel*** | 7.000 | Charlie Gee (32%), **65 cable operators** (25%)**** **TCI** (10.5%), **United** (10.5%) |
| ***Country Music*** | 6.700 | Jim Guercio (principal owner) |
| ***Acts*** | 6.000 | Southern Baptist Convention |
| ***Travel Channel*** | 5.700 | TWA Marketing (100%), after equity offering TWAM will hold 63%, **cable operators** 37%***** |
| ***HSN II*** | 4.200 | Home Shopping Networks Inc. |
| ***Movietime*** | 3.200 | Employes (30%), Mabon, Nugent & Co., SRK Management, Loeb Partners and Hallmark (70%) |
| ***Shop TV*** | 2.500 | JC Penney (63%), STN (37%)****** |
| ***WPIX*** | 2.471 | Tribune Broadcasting |
| ***Hit Video USA*** | 2.100 | Wodlinger Broadcasting |
| ***KTVT*** | 1,891 | Gaylord Broadcasting |
| ***Nostalgia*** | 1,400 | **Cooke Cablevision** (9%), **TeleCable** subsidiary has small percentage, largest single owners |
| ***Liberty*** | 1,049 | Liberty Broadcasting Network (nonprofit) |
| ***Consum. Disc. II*** | 1.000 | Entertainment Marketing Inc |
| ***Sky Merchant*** | 1.000 | Jones Int'l. (parent of **Jones Intercable**) |
| ***America's Shop.*** | 1.000 | **Cox Cable** |
| ***Galavision*** | 900 | Univisa |
| ***Gospel Music Net.*** | 844 | GMN Ltd |
| ***Motivation Net.*** | 600 | Rock Christian Network (nonprofit) |
| ***CDN I*** | 526 | Entertainment Marketing |

### Pay services

| *Network* | *Subscribers* | *Ownership* |
|---|---|---|
| ***HBO*** | 15,000 | **Time Inc.** |
| ***AMC*** | 7,000 | Rainbow Program Enterprises (**Cablevision Systems**) 50%, **TCI** 50% |
| ***Showtime*** | 5,300* | **Viacom** |
| ***Cinemax*** | 4,100 | **Time Inc.** |
| ***Disney*** | 3,175 | Walt Disney Co. |
| ***Movie Channel*** | 3,000* | **Viacom** |
| ***Playboy*** | 520 | Playboy Enterprises |
| ***Bravo*** | 500 | RPE **(Cablevision Systems)** |
| ***Festival*** | 30 | **Time Inc.** |

*Estimate. Showtime does not breakout figures for Showtime/The Movie Channel

### Pay-per-view services

| | | |
|---|---|---|
| ***View. Choice I,II*** | 4,000 | **Viacom** |
| ***Request TV*** | 2,500 | **Daniels, United Cable, Centel, Heritage, American,** major motion picture studios |
| ***Home Premiere*** | 2,300 | **ATC, Cox, TeleCable, Continental** and **Newhouse** 20% each. |
| ***Cable Video Store*** | 40 | General Instrument |

Bold face in right-hand column indicates cable operator ownership or ownership by company with cable systems in separate subsidiary

*CVN—The ownership by **18 cable operators—American, ATC, Adam Corp., Cablevision, Colony, Continental, Cooke, Daniels & Associates, Heritage, Newhouse, Rogers, Sammons, TCI, Times Mirror, United Artists, United, Viacom, Warner**—s based on percentage of subscribers committed to service

**Telshop—FNN is offering equity to **cable operators** (500,000 shares) FNN will retain two million shares

***QVC Network—It is presenting owned by the public (65%), **Comcast** (14%) and **cable operators** (21%). When cable operators exercise warrants on 483,000 shares of preferred stock, redeemable for 10 shares of common stock, another 4.83 million shares will be added to the approximately 10 million shares outstanding. At that point, cable operators would own approximately 8.5 million shares of the 15 million shares outstanding, or **56%** of the service. The largest in that group would be **TCI** (2,150,000)

****Fashion Channel—Among the larger cable operators with an equity stake are **Adelphia, American, ATC, Barden, Bresnan, Cablevision Industries, Centel, Century, Colony, Commonwealth Cablesystems, Continental, Cooke, Cox, Daniels, Enstar, First Carolina, Harron, Hauser, Heritage, Lenfest, Maclean Hunter, Marcus, Media General, Newhouse, Omega, Post Newsweek, Prestige, Sammons, Scripps Howard, Simmons, Susquehanna, Sutton Capital, Taft, TeleCable, TCI, Times Mirror, Triax, UA, United, United Video Cablevision, Viacom** and **Warner**

*****Travel Channel—The final equity offering is to be placed by Dec. 1, whereby TWA Marketing will retain 6 million shares and **cable operators** will be offered 3.5 million.

******Shop TV—It has equity commitments from **30 MSO's** representing 3.3 million subscribers. MSO's will receive 1% equity in the service for each million homes they commit to. Cable operators who have major stakes in other shopping programs, such as TCI, United and Comcast, are not a part of Shop. Among the MSO's whose systems are carrying Shop TV are Cablevision Systems, Rogers, Continental and Warner.

## Regional sports ownership

### Pay services

| | | |
|---|---|---|
| Sportschannel New York | 1,015,000 | **Cablevision Systems** |
| Home Team Sports | 720,000 | **Group W** |
| Prism | 400,000 | **Cablevision Systems** |
| Pro-Am Sport Systems | 317,080 | Thomas Monaghan, Detroit Tigers owner |
| New England Sports Network | 210,370 | Boston Red Sox (34%), Bruins (34%), **SCI Television** (30%), New Boston TV Inc. (2%) |
| **Basic and tier services** | | |
| Madison Square Garden Network | 2,120,000 | Gulf & Western |
| Prime Ticket | 1,800,000 | Jerry Buss (50%), **Bill Daniels** (50%) |
| SportsVision Chicago | 1,000,000 | **Cablevision Systems** |
| Pirates on Cable | 925,000 | **TCI** |
| Sportschannel New England | 725,000 | **Cablevision Systems** |
| Home Sports Entertainment | 574,400 | Houston Sports Association |
| Sabres Network | 500,000 | Buffalo Sabres |
| Utah Jazz | 325,000 | Utah Jazz and **TCI** joint venture |
| Arizona Sports Programing Network | 170,000 | **Times Mirror Cable** |
| Trail Blazers | 143,000 | Portland Trailblazers |
| Sportschannel Florida | 35,000 | **Cablevision Systems** |

Bold face denotes ownership by cable operator or company that operates systems through another subsidiary. Subscriber figures are from Paul Kagan Associates.

Senator METZENBAUM. Thank you, Mr. Foster. Why do you think programmers have refused to deal with you? Would they not want the largest possible subscriber base?

Mr. FOSTER. That would seem to be the case, would it not, Mr. Chairman. You would think that the programmers would want to get as many "eyeballs" viewing them as they possibly could, especially the advertising-supported services. However, if they were being pressured by the large MSO's not to introduce another competing technology, then they would not sell to us. So, therefore, we believe the programmers are being pressured by the large MSO's.

Senator METZENBAUM. What is the difference between your concept of delivery and Mr. Theroux's concept of delivery?

Mr. FOSTER. None, sir.

Senator METZENBAUM. Is it logical to think that the wireless industry could create its own programming?

Mr. FOSTER. If we were to grow as large as cable—and only when cable began to grow did it acquire its own programming—yes, then we could. However, it is going to take millions and millions of dollars to do that. We in the old MDS business carried HBO before cable did in some instances, and HBO did indeed utilize our system throughout the years. So therefore, we have had access to HBO during that period of time.

Senator METZENBAUM. Do you still have it?

Mr. FOSTER. We do still have it. We were grandfathered.

Senator METZENBAUM. Under your system, do you have to go only into one area of the community, or can you go into the affluent and the not so affluent? Cable goes into a particular segment of the community or the totality of the community depending upon the circumstances. With your system, can you cover the entire community, or are there limitations on that?

Mr. FOSTER. We can cover the entire community. Our medium, Mr. Chairman, is a medium of homes reached not homes passed. So therefore——

Senator METZENBAUM. I am sorry?

Mr. FOSTER. Our medium is a medium of homes reached, not homes passed. So, therefore, we do not have to wait until a wire goes down the street to serve an individual home. We can serve any home within our coverage area, and we do. We can serve it in the middle of the Bronx, we can serve it in the middle of Brooklyn, or we can serve it in Westchester. We can serve wherever our signal goes, which is roughly a 20-mile radius.

Senator METZENBAUM. If you do not get the programming of some of the more desirable programming that is now on TV——

Mr. FOSTER. I am sorry, sir?

Senator METZENBAUM. If you do not get, if you are not able to obtain the quality programming that is now available on cable TV, do you see an economic distress signal sometime in the future for the wireless operators?

Mr. FOSTER. Yes, sir, indeed I do. As long as you sell half a loaf, you cannot sell the entire service. I could give you one example of that. If A&P were to sell only Jane Parker foods and not the name brand foods, I do not know how many people would go to A&P.

Senator METZENBAUM. Thank you very much.

Senator Humphrey?

Senator **Humphrey**. Mr. Foster—and Mr. Theroux may answer as well if he wishes—how do you compete with conventional cable? I mean, are you able to offer services more cheaply or what?

Mr. **Foster**. Our service is perceived by the subscriber, the consumer in exactly the same way as cable. And we offer the tiering, the addressability. We will be offering the pay per view. We will be offering the volume control on our remote unit. We will be offering the wide variety of services. So, therefore, we do have a directly competitive service to regular coaxial cable. The only difference is that our signal comes down from the roof.

As far as price is concerned, our price is expected to be, and is now, approximately 15 to 20 percent less costly to the consumer than cable is.

Senator **Humphrey**. Why is that? Is it your operating——

Mr. **Foster**. Our capital cost is about one-fourth the cost of the capital cost involved in stringing cable.

Senator **Humphrey**. Mr. Theroux?

Mr. **Theroux**. We try to compete on a price basis. And we can do it partly because our capital costs are lower, but also because the cable monopoly has now priced itself so high that there is plenty of room for us to price beneath them.

But beyond that, we also compete by giving a more reliable service. In cable, you may be familiar, there are what are called outages. The cable just goes off when there is a storm or whatever. But our technology is a broadcast technology that has backup power, backup everything. We never have outages. So that is a benefit that we give consumers.

Senator **Humphrey**. I take your potential—your signal is line of sight essentially; is that correct?

Mr. **Foster**. The signal is line of sight except that there are many, many instances where the signal does bounce. We will reach in the city of Detroit, for example, about 96 percent of the homes. I think that is extending line of sight pretty well.

Senator **Humphrey**. But your potential is limited pretty much to metropolitan areas.

Mr. **Foster**. No, sir. The potential for wireless cable goes throughout the United States. Our current focus is in the urban markets because those are the areas where cable has not yet come. So, therefore, we are trying to serve the unserved, the people who do not have access to old-fashioned cable. Just as one of the former witnesses said, there are people in New York who are looking forward to seeing the Bronx Bombers, but they cannot see them because they don't have access to cable. We could deliver it if we had the programming.

Senator **Humphrey**. Practically speaking, do you expect your industry to expand into the countryside?

Mr. **Foster**. No, sir, our industry is a niche business. It is a business that can provide service to the many, many people who do want service. We have not said that we are going to destroy cable in the slightest. Cable has said they want to destroy us. But we have never even had the temerity to think of destroying cable. We are providing a service to people who cannot get it.

Senator **Humphrey**. That was my earlier question, that your potential is pretty much restricted to metropolitan areas, practically speaking.

Mr. **Foster**. Yes, sir.

Senator **Humphrey**. In terms of economics.

Mr. **Theroux**. Senator, could I say that the members of our wireless cable association are right now, as we speak, planning to begin wireless cable in less densely populated areas as well. It is going to be a national event.

But let me say that, in the near future, as wireless cable grows, the cost of its equipment and transmitters could go down so far that even the smallest town could have a wireless cable operator. This is perfectly possible and I think it will happen in the future.

Senator **Humphrey**. I see. Thank you.

Senator **Metzenbaum**. The range generally is about 20 miles?

Mr. **Foster**. In general, the coverage area is about 20 miles depending on a number of local conditions. And I do want to echo what Mr. Theroux has said. There are many pockets in the United States that do not have cable. And there are millions of people in small towns as well as large towns who could have access to the cable programming through wireless cable.

Senator **Metzenbaum**. You are in business promptly as soon as you put an antenna on the property?

Mr. **Foster**. Yes, sir. If you want to use that analogy, as soon as we have turned on our transmitters in the community, we immediately pass the homes of the community. So therefore, we are in business immediately.

Senator **Metzenbaum**. If there is an apartment complex, do you need one antenna or 60 antennas?

Mr. **Foster**. Our intent is to provide service on an addressable basis to individual apartments within that building. One master antenna, in effect, serves the building. So, therefore, from the rooftop down we have a minicable system. To the roof, it is transmitted by over-the-air transmission. But within the building, it is a minicable system.

Senator **Metzenbaum**. Thank you very much, Mr. Foster.

Mr. **Foster**. Thank you, Mr. Chairman.

Senator **Metzenbaum**. Mr. Kocian, happy to have you with us, sir.

## STATEMENT OF GEORGE KOCIAN

Mr. **Kocian**. Thank you, sir. Mr. Chairman, members of the subcommittee and staff, thank you for the opportunity to appear before you to speak about issues which will impact directly on the ability of Americans to receive television information and entertainment from competitive sources. I am the owner of Tiverton Dish Farm in Brinkhaven, OH. I am also pleased to be the spokesperson for the Home Satellite Television Association, HSTA.

HSTA is the trade association representing consumers and retail sellers of home satellite earth station equipment throughout the country. Our members come from nearly all of the 50 States and several foreign countries. Our members are extremely concerned over the future viability of direct-satellite-to-home technology to provide a meaningful service to the public and competition to cable television.

Our concern stems from the fact that cable television companies control the lifeblood of home satellite earth stations. That lifeblood consists of programming. Cable companies own and control all the major nonbroadcast satellite-delivered services.

Many years ago the Standard Oil Co. antitrust battle was waged because of the enormous amount of power and control that was found to be in the hands of but a few. I can see in today's cable industry a similar pattern.

When HBO first initiated its scrambling, the introduction was accompanied by a massive campaign of negative advertising fostered by one of the cable industries major trade associations. It formed a consortium to ensure that services would be scrambled without delay and would be scrambled in a cable-friendly manner. This meant that scrambling would be accomplished in a manner that would not harm the interests of the cable television companies.

For example, when HBO and Showtime 2 years ago initiated their scrambling plans, a major portion of that plan was a kickback by each programmer to any cable television company of $5 per month for any sale the programmers made to a dish owner in the cable operator's area. After the spotlight was turned on these activities in hearings before the Senate and House, they were abandoned.

The technology exists to have real competition between cable television and home satellite earth stations. A competition which our members believe would benefit the American consumer by giving choice and acting as an effective regulator of cable prices. That robust competition does not exist today because the cable television industry discriminates and controls the source of programming, and opens the tap in such a manner so as not to harm its basic underlying business.

Every home satellite earth station owner in a cable area is a potential loss of a cable subscriber whose book value is about $2,000, and thus the incentives exist for major cable television companies and the programming services which they control, to price programming in a cable-friendly manner. And that is just what they have done.

HSTA is not opposed to scrambling. Consumers are willing to pay a fair price for what they choose to watch. Satellite dealers expect to be paid for their product. Competition exists in the earth station hardware business except decoders. There is very limited competition in the marketing of satellite programming. One look at the corporate makeup of virtually all of the major satellite programmers shows that they are owned or controlled by either TCI, ATC or Viacom, all cable television multiple-system operators.

If discrimination did not exist and competition did, would one logically expect that there would have been no $5 kickback to the cable companies? Or having renounced that kickback, that dish consumers would have had their rates dropped by $5? This did not happen.

When TCI, the Nation's largest cable company purchases, for example, CNN for its subscribers, it pays a rate of approximately 2 cents to 17 cents a month. When it purchases the identical programming for viewing by home dish owners, it has agreed to pay the rate of $1 per month. This is great disparity.

And by paying such a higher wholesale rate, TCI ensures that the retail rate to the dish subscriber will be far higher than it would otherwise be. By paying this higher rate, TCI, which is the largest purchaser of satellite programming, has also set a floor on what others will be charged for sales to dish owners.

This differential cannot be explained by processing charges or backroom billing costs. The major independent-of-cable would-be distributors, such as the National Rural Electric Co-op and the Amway Corp., have both stated they would cover those costs in their distribution of programming to home dish owners. Yet neither service has been able to contract with the major subscription services for delivery of their programming to home dish owners. The reason is because cable is in control.

To help resolve these issues, we support passage of S. 889. Should real fair competition still not exist for whatever reason, another solution would be the imposition of structural separations. Keep cable out of the programming business.

Mr. Chairman, members of the committee, I would be happy to respond to your questions. Thank you.

[The prepared statement of Mr. Kocian follows:]

# TESTIMONY OF GEORGE KOCIAN

BEFORE

THE SENATE SUBCOMMITTEE
ON ANTITRUST, MONOPOLIES & BUSINESS RIGHTS
OF THE JUDICIARY COMMITTEE

MARCH 17, 1988

ON BEHALF OF

THE HOME SATELLITE TELEVISION ASSOCIATION

Of Counsel
Brown, Finn & Nietert, Chartered
1920 N Street, N.W., Suite 510
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(202) 887-0600

## Testimony of George Kocian

Mr. Chairman, members of the Subcommittee and staff — thank you for the opportunity to appear before you today to speak about issues which will impact directly on the ability of Americans to receive television information and entertainment from competitive sources. I am the owner of Tiverton Dish Farm in Brinkhaven, Ohio. I am also pleased to be the Chairman of the Home Satellite Television Association ("HSTA"). HSTA is the trade association representing consumers and retail sellers of home satellite earth station equipment throughout the country. Our members come from nearly all of the 50 states and several foreign countries. We have been pleased to represent interests of consumers and dealers of home satellite earth station equipment before the Congress and the Senate on four separate occasions within the last year.

Our members are extremely concerned over the future viability of direct satellite to home technology to provide a meaningful service to the public and competition to cable television. Our concern stems from the fact that cable television companies control the life blood of home satellite earth stations. That life blood consists of programming. Cable companies own and control virtually all the major non-broadcast satellite-delivered services. People buy home satellite dishes because they wish to view programming. Since the very start of the direct-satellite-to-home transmissions, cable companies sought to prevent the growth of this potentially competitive technology by denying programming to it and, unable to achieve that result, to control its evolution by seeking to ensure that programming to dish owners would only be available in a "cable-friendly" manner.

Consumers began purchasing home satellite earth stations in 1979. Today, nearly two million homes receive their television directly from the satellite by means of a home satellite antenna. In most cases, those homes lie outside the reach of a full selection of over-the-air television stations or cable television. However, in a growing number of cases, consumers wishing to choose what services they receive and willing to pay a fair rate for such services, look to a satellite dish.

When consumers first began purchasing home satellite antennas, the reaction was swift. In 1980, then-Congressman Richardson Preyer introduced legislation which would have, had it passed, outlawed the use of home satellite antennas. All the major subscription services refused to accept payment from dish owners taking the position that they would only sell to the public through cable companies. The situation hasn't changed that much. Today, Turner Broadcasting & HBO are still denying access to their new Festival and TNT services to dish owners. In 1983, a major cable television multiple-system operator brought suit against the retail seller of home satellite earth stations in Federal Court in Witchita, Kansas, alleging that the sale of home satellite antennas was against the law. While the cable system ultimately lost, the dealer went out of business. Services such as Home Box Office wrote letters to manufacturers of home satellite equipment alleging that the manufacture and sale of that equipment was a violation of law. Zoning ordinances were passed in communities from Plantation, Florida to Chicago, Illinois whose primary purpose was to protect the interest of the cable television companies from competition by direct-to-home satellite communications.

When HBO first initiated its scrambling, one of its executives was widely quoted as saying "the skies would go dark for dish owners." The introduction was accompanied by a massive campaign of negative advertising fostered by one of the cable industry's major trade associations. Original efforts to ensure that signals would be scrambled were orchestrated by the National Cable Television Association. It formed a consortium to ensure that services would be scrambled without delay and would be scrambled in a "cable-friendly" manner.

By "cable friendly," the cable industry meant that scrambling would be accomplished in a manner that would not harm the interest of the cable television companies. For example, when HBO and Showtime two years ago initiated their scrambling plans, a major portion of that plan was a "kickback" by each programmer to any cable television company of $5 per month for any sale the programmers made to a dish owner in the cable operator's area. The absurdity of this proposition may be seen when it is recognized that the reason that the consumer purchased his/her home satellite antenna was either that the cable company had not bothered to provide service to him/her or the service was of an inferior quality and the consumer chose instead to buy a dish. Why should the cable company be rewarded for this? After the spotlight was turned on these activities in hearings before the Senate and House Communications Subcommittees, they were abandoned. These symptoms are gone. Others still exist, and the disease is getting worse.

The technology exists to have real competition between cable television and home satellite earth stations, a competition which our members believe would benefit the American consumer by giving him/her choice and acting as an effective regulator of cable prices. Unfortunately, that robust competition does not today exist. It does not exist because one competitor, the cable television industry, controls the source of programming and opens the tap in such a manner so as not to harm its basic underlying business. Cable television companies today value each subscriber at approximately $2,000. Every home satellite earth station owner is a potential loss of a cable subscriber. Thus, the incentives exist for major cable television companies and the programming services which they control to price in a "cable-friendly" manner. And that is just what they have done.

HSTA is not opposed to scrambling. Consumers recognize that subscription programmers must be paid for their product. Satellite dealers are businessmen and they too expect to be paid for their product. The difference is that there is competition in the manufacturing and sale of satellite earth station hardware (except decoders). There is very limited competition in the marketing of satellite programming. This is because when one looks at the corporate makeup of all of the major satellite programmers (HBO, Showtime, Turner Broadcasting, MTV, Nickelodeon, Cinemax, The Movie Channel, etc.), one finds that they are owned or controlled by either TCI, A.T.C. or Viacom, all cable television multiple-system operators. While HBO and Showtime may compete for cable subscribers, they most definitely are not engaged in vigorous competition for home dish viewers. If they were, one would logically expect that there would have been no $5 kickback to the cable companies or having renounced the kickback that dish consumers would have had their rates dropped by $5. This did not happened.

Let us look at one example. When TCI, the nation's largest cable television company purchases CNN for viewing by its cable subscribers, it pays a rate of approximately $.02 - $.17 per month. When it purchases the identical programming for viewing by home dish owners, it has agreed to pay the rate of $1.00 per month. This is a great disparity and by paying such a higher wholesale rate, TCI ensures that the retail rate to the dish subscriber will be far higher than it would otherwise be. By paying this higher rate, TCI which is the largest purchaser of satellite programming, has also set a floor on what others will be charged for sales to dish owners. This differential cannot be explained by processing charges or backroom billing costs. The major independent-of-cable would-be distributors such as the National Rural Electric Coop and the Amway Corporation have both stated that they would cover those costs in their distribution of programming to home dish owners. Yet, neither service has been able to contract with the major subscription services for delivery of their programming to home dish owners. The reason for this is cable control.

The cable industry has argued that the rates for subscription programming to dish owners are about the same as those to cable subscribers. This is misleading and an "apples" and "oranges" comparison. Approximately 50% or more of the rate that a cable subscriber pays each month goes to pay off the cost of the cable plant and service required to get that consumer the signal. A dish owner has already paid that cost when he/she has purchased a satellite dish. So you are comparing different services. You are comparing apples on the tree and apple pie. If a market existed, dish owners should pay substantially less than cable subscribers. Also, such comparisons fail to mention a $400 decoder cost dish owners must pay.

No independent-of-cable or "third-party" packagers have been able to develop a complete package of programming for sale to dish owners, although many have tried. Absent the existence of such packagers that have a real incentive to aggressively pursue this market, real competition in the delivery of satellite services to residential consumers will never exist.

Even the basic question of access of home dish owners to satellite programming is in question with the recent announcement that HBO's new KU-Band services and "TNT" proposed by Turner Broadcasting may not be offered to home dish owners. Consumers are almost back to where they were a half decade ago — fighting for basic access to satellite programming.

There is another form of exclusivity that is just as harmful and that is the exclusivity provision which the satellite packagers such as HBO obtain from the major Hollywood studios. These contracts often give the satellite packagers an exclusive over the studio's product for delivery over a national satellite distribution network. This exclusivity will severely restrict future would-be packagers of programming from being able to enter either the packaging for cable subscriber business or the packaging for the direct satellite-to-home market. Cable is leveraging its control over access to existing cable homes into future control over access to all homes which can be served by satellite. In the process it is unfairly restricting competition by denying consumer choice.

One other area of anti-competitive action may be seen in the growing problem of piracy. General Instruments Corporation has a de facto monopoly over manufacture and control of scrambling technology. It has set prices for its hardware artificially high. Unlike every other item of consumer technology, they have not been reduced over time.

Despite assurances from that company, sometimes parroted by regulatory agencies, it has been unable to stop the growing problem of signal piracy. Thousands of dish dealers have been faced with the alternative of going out of business or marketing illegal chip sets which allow viewing of programming without payment of it. These chip sets are not cheap and may cost a thousand dollars or more. HSTA does not support this activity. It is firmly opposed to piracy. HSTA does point out, however, that if the marketplace really did exist, prices would be reduced to a level that would minimize incentives to purchase illegal chips. Black markets usually exist where there are no free markets and that is the situation with respect to satellite programming and decoders. Efforts in the courts alone will not even come close to stopping this activity. So long as the price of satellite programming is artificially high, there will be an incentive by some to engage in piracy. While we favor aggressive anti-piracy campaigns, we are not naive enough to believe that this alone will solve the piracy problem.

To remedy the problems which we see in the marketplace, HSTA has supported S. 889 and continues to vigorously support this legislation. By providing competition to cable television companies in the form of fostering independent-of-cable third-party packagers of programming, we believe that a competitive marketplace is most likely to exist. If S. 889 is not passed, and if the third-party packagers continue to be unsuccessful in their efforts to obtain marketing rights under terms and conditions no less favorable than cable operators are able to obtain satellite-delivered programming, then the future of the satellite-to-home communications will be in the hands of the cable television companies. One solution would be the imposition of structural separations — separate control over programming from the means of its delivery. Keep cable out of the programming business.

There are many precedents for this action. Forty years ago, the courts saw the potential for anti-competitive behavior and restricted the ability of the Hollywood studios to own movie theater outlets at an early stage of those industries' developments. Several decades ago, the FCC and more recently the Congress, saw the potential which a local broadcaster has to prevent competition from a cable company in its service area. They acted to prevent this cross-ownership. These rules were codified in the 1984 Cable Act. Broadcasters cannot own cable companies in their local service area. These rules have worked well. As a result, both industries have thrived.

It is not too soon, in fact, we desperately hope that it is not too late to begin considering this type of structural remedy in the case of the sale of programming to home satellite antenna owners. If independent-of-cable third-party programmers are not permitted to purchase at wholesale, for sale at retail the same way cable operators do for sale to their subscribers, then we believe that a separation's policy of hardware from software must be considered. We reach this conclusion only reluctantly. But we have waited since the beginning of this decade and have only seen more and more control exercised by the cable industry over the satellite-to-home industry to the detriment of the consumer. The disease is spreading. S 889 is one cure. Structural separations is another.

Thank you Mr. Chairman and members of the subcommittee. I would be happy to respond to any questions which you may have.

Senator **Metzenbaum**. I have some questions.

But first, I think I would like to hear from Mr. Burke, who I understand represents the United Satellite Industry Association, North Little Rock, AR. Mr. Burke?

## STATEMENT OF THOMAS BURKE

Mr. **Burke**. Thank you, Mr. Chairman. I have been a satellite dealer since 1979. And at one time in 1986, January of 1986, there were approximately 12,000 satellite dealers in the United States. I have been a spokesman for the industry since the inception of the programming scrambling.

In 1985, we were selling over 50,000 satellite systems per month. Today, there is less than 2,000 satellite dealers left. What has happened? Have we failed in the marketplace? Is there better competition that is selling systems for us? That is not true. Have the prices risen in the satellite systems so that the consumer will not buy it? No, in fact, prices are half today what they were in 1985.

The reason for the failure of the satellite systems was brought up when I testified before the Commerce Commission in 1986, and the same is true today. The failure rate of the satellite dealer, distributor and the manufacturer is a direct result of an orchestrated conspiracy by the cable industry. A conspiracy to effect control of our industry growth, to prevent a competitive market and thereby extend the monopolies they now enjoy into areas that they never intended to serve.

As our technology progressed and prices became much lower than they were, people in the cities, for the first time, had an alternative to the cable programming. Purchase a satellite system! The cable companies, realizing that they were in basically a dinosaur world and facing our high technology, concentrated their efforts. In a concentrated industry, which exists, they shut off the supply of programming, leaving the dealers without anything to sell.

In 1984, cable programmers were given authority to scramble and they did so. But before they set up a distribution system for the TVRO. In short, the cable industry correctly viewed the TVRO market as its strongest competitive threat and then shut off the supply of programming. Even though the whole point in TVRO is so the consumer does not have to get his programming through the cable system, when you limit the competition, economics teaches you that prices stay high and consumers are hurt.

Now we know that HBO and all the other programmers deserve to be paid for their programming services. Neither I nor any of the other dealers that I represent support any illegal efforts to pirate cable satellite programming. But the cable industry has used scrambling to squelch competition from our industry. If you want to see programming with your satellite dish today, you must buy it from the cable industry.

There are three reasons why I think there is a conspiracy. First, virtually all major programmers scrambled at approximately the same time in 1986 and 1987. The lawyers tell me that concentration in a marketplace makes collusion easier, and it certainly appears that way in the cable industry.

Second, all the programmers selected a single company to manufacture the necessary descrambling equipment and to operate the descrambling system. The cable industry knew what it was doing there.

Third, and overlooked by many people but brought up by these gentlemen, almost all of the major cable programmers are vertically integrated, are owned jointly or affiliated with MSO's. When the cable systems scream, the programmers really jump.

Now I do not have any absolute proof of a conspiracy. I do not have a smoking gun document showing the members of this conspiracy, but I do think this evidence exists. Now I understand the Justice Department reported last year that it had not found sufficient evidence to prove a conspiracy. But given what I know about this administration on antitrust, I do not believe the Justice Department would recognize a conspiracy if it hit them on the head. [Laughter.]

Mr. **Burke**. In 1986 I stated, 20 months ago, the cable companies, fearing competition from our high-tech distribution are denying us programming through manipulation of the cable programming association. In a last-ditch effort in 1986 to salvage our business, we the dealers banded together and formed a satellite dealers co-op. We wished to purchase at that time, and still do, a compatible decoder and market it with the programming.

In summation, we the satellite dealers who sold all those dishes, we maintain them, we know the names of those people, their dogs, everyone else, they are on a friendly atmosphere with us. We can provide rural America with programming and serviceable decoders. Nobody else can do it in a friendly atmosphere.

And somewhere in this mass of confusion I stated in 1986, a solution must present itself. The solution to all the problems will not come easily. But the dealers survival package can be obtained when wholesale distribution by qualified third-party distributors is accessible to the TVRO owner. We are willing to work with the programmers and market their product. We just want to be able to do it on an equitable, fair and reasonable, level playing field.

In closing, Mr. Chairman, the TVRO industry has been decimated, not because it could not compete but rather because it competed too well.

[The prepared statement of Mr. Burke follows:]

# STATEMENT OF

# TOM BURKE

# NORTH LITTLE ROCK, ARKANSAS

Mr. Chariman - members of this committee.

Since 1979, I have served my community as a retail TVRO Satellite Dealer. In addition, I serve as president of the United Satellite Industries Association - a retail dealer group encompassing forty-nine states.

I have experienced the rise of the satellite industry from nothing to a viable multimillion dollar entity, and I have seen the demise of this same industry in a short 24 months.

The satellite industry is in shambles. The TVRO dealers, distributors, and manufacturers are disappearing at an alarming rate. There were approximately 12,000 dealers in 1985, selling more than 50,000 TVRO systems per month; today there are less than 2,000 dealers.

The failure rate of the satellite dealer, the distributors, and the manufacturer is a direct result of an orchestrated conspiracy by the cable industry: a conspiracy to effect control of our industry growth, to prevent a competitive market, and thereby extend their monopoly they now enjoy into areas they never intended to serve.

Have we been beaten in the market place by larger more efficient nationwide retailers NO. Have equipment prices risen, so that consumers cannot afford our product NO. Quite to the contrary, prices for TVRO systems today are half of what they were in 1985, and there are no "Montgomery Ward" type firms in our retail business.

There are very large firms in the cable television industry, however. Companies such as Time and Tele-Communications, Inc., were huge in 1984 and are vastly larger today. Concentration in the cable business is steadily increasing, while the Federal Trade Commission, the Justice Department and the FCC stand by and do nothing. Cable MSO's are expanding horizontally, by buying more and more cable systems, and vertically, by integrating with cable programming services, and all at an alarming rate, it is hard to belive that with all the mergers and acquisitions over the past few years, none of them raised enough antitrust concerns to merit even an investigation by these federal agencies.

TVROs started as an alternative to cable television, allowing consumers in areas where cable had yet to reach to receive programming directly off the satellite. As technology progressed and our prices fell dramatically, TVROs became a real competitive threat to local cable systems, because consumers -- for the first time -- had an economic alternative to subscribing to cable television.

The cable industry realized this and reacted in a manner typical of large, concentrated industries: they shut off the supply of programming, leaving dealers without anything to sell. By refusing to deal with the satellite market, cable programmers and cable systems have preserved their local monopolies and made it virtually impossible for satellite dealers to compete.

This is not the first time this has happened. HBO, for example, for years refused to sell programming to SMATV systems, private cable systems in apartment complexes, and the like, to protect the cable systems of its sister company, ATC. In 1984, cable programers were given the authority by Congress to scramble their signals. They did so. But they scrambled before they had set up any distribution system for TVRO owners. And when they finally set up a distribution system, they refused to allow satellite dealers into the system, instead limiting distribution rights only to cable systems.

Now HBO refuses to sell to overbuild cable companies who install a second competitive system within a given area. In short, the cable industry correctly viewed the TVRO market as its strongest competitive threat, and then shut off the supply of programming to that market. Virtually across the board, TVRO owners must now pay the local cable system for their programming -- at prices higher than those charged to cable subscribers -- even though the whole point of TVROs is that the consumer doesn't have to get his programming through the cable system. When you limit competition like this, economics teaches that prices stay high and consumers are hurt. Here, the TVRO consumer is being ripped off and the TVRO dealer isn't permitted to sell programming to his customer.

To be sure, Mr. Chairman, there is nothing wrong with scrambling; HBO and other programmers deserve to be paid for their programming services. Neither I nor any of the dealers I know support illegal efforts to "pirate" cable satellite programming. But the cable industry has used scrambling to squelch competition from the dish market. The programmers have kept prices high and preserved the monopoly that local systems enjoy over distribution of programming. If you want to receive programming with your TVRO, you've got to buy it from the cable industry.

There are three reasons why I think cable scrambling policies are the result of a conspiracy. First, virtually all major programmers scrambled at the same time, in 1986-87, and did so before they had any real plan for selling the programming to the dish market. Lawyers tell me that concentration in a market makes collusion easier; that certainly is the case in the cable industry.

Second, all of the programmers selected a single company to manufacture the necessary de-scrambling equipment and to operate the de-scrambling system. The shortage of de-scrambling equipment, which still continues, shows that the cable industry knew what it was doing.

Third, and overlooked by many people, almost all of the major cable programmers are vertically integrated, owned jointly or affiliated with MSOs. When the cable systems scream, the programmers listen. If you go back and review the record, I am sure you will find that cable systems argued and pressured programmers into scrambling to protect the systems from competition from dishes. So, there was a vertical conspiracy (between systems and programmers) as well as a horizontal conspiracy (among programmers).

Mr. Chairman, I don't have absolute proof of this conspiracy. I don't have a "smoking gun" document showing the members of the conspiracy. I do think this evidence exists. The Justice Department is still conducting an antitrust investigation into these scrambling issues. If they have the evidence, then their refusal to take action is an abdication of their responsibilities. If they don't have the evidence, then their inability to get it is even worse.

I understand the Justice Department reported last year that is hadn't found "sufficient evidence" to prove a conspiracy. Given what I know of this Administration's antitrust policies, I don't think they would recognize a conspiracy if one hit them over the head.

In closing, Mr. Chairman, the TVRO industry has been decimated not because it couldn't compete, but rather because it could compete too well. The cable industry sees satellite dishes and dealers as the major threat to their local cable system monopolies. They have used scrambling to foreclose our access to programming and preserve those monopolies. Consumers who bought dishes in order to avoid dealing with cable systems now must deal with them while the satellite dealers are left out in the cold. All this, I believe, is the result of a conspiracy among cable systems and cable programmers.

Thank you for you attention. I remain available for any questions.

Senator METZENBAUM. Thank you, Mr. Burke.

Mr. BURKE. Thank you, sir.

Senator METZENBAUM. Let me be clear on the record. As I understand it, your complaint is not that you cannot obtain the programs, but that the program is not made available on a fair basis. Is that correct?

Mr. BURKE. Yes, sir, that is correct. As a comparison, there is a Superstar Connection it is called, Mr. Jack Riley operates it out of Tulsa, OK. I think there is three major superstations there, WPIX, KTVT, and WGN. On November 8, 1986, Mr. Riley and I, we were with a group of people in Washington and he divulged to us that he was selling those three programs at that time to cable companies at 25 cents per month per subscriber; 10 cents, 8 cents and 7 cents if you took all three of them.

We informed the co-op. At that time, I offered him twice that amount, or $6 a year. And we agreed—and I had thousands of pledges from dealers all over the country—we agreed to purchase hundreds of thousands of units at $6 per year. Mr. Riley refused at double the price of cable and on a volume basis. At that time the price to us was $36 a year as compared to $3 a year. So that is 12 times the amount.

This is the reason, sir, that we are in the situation we are in right now, its disparity in the pricing! The cable company basically has control of those programmers and they refuse to allow distribution to a third party in competitive prices.

Senator METZENBAUM. Thank you, Mr. Burke.

HBO will testify, Mr. Kocian, that it sells its HBO directly to home dish owners at a better price than cable subscribers pay. Do you disagree?

Mr. KOCIAN. I would have to dispute that, sir, on the grounds of an equal comparison. I feel they are not making an equal comparison. It is rather a complicated formula, but just touching on the highlights of that comparison would be, first, a home dish owner has to pay $400 up front for the decoder that is needed to receive HBO on their satellite system. This box is supplied by a cable system at a buck, two bucks, or three bucks a month; monthly charge. That is the first major disparity.

Second is that the rates are not equal from the point of view of a home dish owner that this is his own cable system. He is responsible for the equipment. He is responsible for the service of that equipment. Again, this is a service that the cable company supplies to its consumer, for which the consumer pays.

A few other items along these lines add up to the fact that only about half of what a consumer of cable pays is directly responsible, in terms of programming. The other half is for the cable plant, et cetera. So that at that rate, a dish owner should pay exactly half or thereabouts what a cable consumer pays.

Senator METZENBAUM. In his testimony, Mr. Thomson states that a home dish owner can buy cable programming from TCI for about $10.50 a month while TCI cable subscribers pay about $15. Is that true?

Mr. KOCIAN. It depends on how you read that. I, myself, before I left yesterday to come to this hearing, called TCI, or at least I thought it was TCI. It was from a full-page ad in a current "On Sat" magazine to home dish subscribers. I believe that figure you quote is accurate.

However, when I called, I found out I was not calling TCI, I was calling NetLink. They told me that I would only be able to receive that package, one, if I was close to or in a cable company area. And not only a cable company, TCI cable company area. That is No. 1.

Number two, in that package, as a basic, which is what you are citing for the $10 plus figure, includes some network channels that TCI is presently, I understand, receiving free from the networks. If I can receive that where I am, in Brinkhaven, OH, which I can and cannot, depending on what you want to call quality on the TV set, I will be cut out of those three channels. Those are the network channels.

However, that $10.95 will not be reduced to me. I will continue to pay that.

This and a few other comparisons add up to the fact that no, we are not being treated fairly or equally.

Senator METZENBAUM. Not all cable programming is owned by cable. Is the programming any easier to obtain from noncable owned program companies?

Mr. BURKE. No, sir. There are three at the present time, and only three, that is allowing renewals for third-party programming that they have now, which of course comes through them. I think it is United Video and Prime Time 24, and there is one other.

It would appear that, of course, the cable industry has told those programmers that if you are going to deal out there with the TVRO market, you are going to keep the pricing at a point that we can control the sales of those satellite systems. We do not want that competition in the city.

Mr. Chairman, we welcome the wireless cable into the competitive field that we are in, delivering entertainment to these homes. We are in some of the suburbs and certainly in the rural areas. We would welcome the competition, but there can never be a competitive factor between us unless programming is available to all of us at a competitive price, or the same basically as the cable.

Senator METZENBAUM. Thank you very much. I appreciate the cooperation of all the members of the panel. Thank you.

Our next panel consists of Mr. James P. Mooney, president, National Cable Television Association. If your very distinguished counsel Bill Oldeker is with you, please be good enough to bring him to the table, as well. Mr. Joseph Collins, president of the Home Box Office, Inc., of Washington. Mr. Amos Hostetter, chairman and chief executive officer, Continental Cablevision, Inc., of Boston. Mr. Robert Thomson, vice president, Government Affairs, for TCI, Denver, CO.

We are happy to have each of you with us.

Mr. Mooney, you are on.

## STATEMENT OF A PANEL CONSISTING OF JAMES P. MOONEY, PRESIDENT, NATIONAL CABLE TELEVISION ASSOCIATION, WASHINGTON, DC; JOSEPH COLLINS, PRESIDENT, HOME BOX OFFICE, INC., WASHINGTON, DC; AMOS HOSTETTER, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CONTINENTAL CABLEVISION, INC., BOSTON, MA; AND ROBERT N. THOMSON, VICE PRESIDENT, GOVERNMENT AFFAIRS, TCI, DENVER, CO

Mr. MOONEY. Thank you, Mr. Chairman. I had not understood that our distinguished counsel, Mr. Oldaker was to be with me, so I did not bring him. I hope you will forgive me for that.

Senator METZENBAUM. I know Mr. Oldaker personally and I just thought that if he was with you, I would be very happy to have him with you, not because I thought it was necessary. He is a personal friend.

Mr. MOONEY. Thank you, sir.

Mr. Chairman, if it is agreeable to you, I will summarize my statement, knowing that you are short for time.

It is well known that cable television had its origins as a community antenna service designed to bring broadcast signals to rural areas. With the development of satellite communications, however, we got a chance to be something else.

As cable began to build in more populated areas, it was required to come up with programming. One of the gentlemen on the previous panel said something about people buying programming, and I agree with that. I think that is what they do buy.

We had to come up with programming that was sufficiently different from what was available free, off air, on conventional television in order to persuade people that there was value associated with paying a monthly fee. And thus, the origins of Time, Inc., putting HBO up on the satellite for national distribution. Similarly, that was the incentive for Viacom going ahead and putting services like MTV and Nickelodeon up on the satellite for distribution to cable systems all over the country.

That, incidentally, was also the incentive for the cable industry inventing C-SPAN, which is the first instance of a public affairs network being put up in which public events, including the proceedings of the House and Senate, are transmitted unedited and uncommented on, in order to bring new understanding to the American public of how their government operates.

Senator METZENBAUM. I might say that it is interesting that only a limited number of cable stations carry C-SPAN and some carry just House, some just the Senate. I just would make the point to you that, although I think the service is a superb one and I have heard great comments about it from people throughout my own State, and the country as well. In my own State, I do not think that hardly any of the stations carry the Senate and a number of them carry the House, but not all of them, that is for sure.

It is one thing to create a system. It is another thing to see that once it is on the box, it is fine. But if it is not being carried, what value does it have?

Mr. MOONEY. We understand your comment, Senator. We encourage the carriage of C-SPAN. The cable industry is undergoing one of its periodic shortages of channel capacity. The average system today still has only 35 channels. I think that as these systems are rebuilt and more capacity becomes available, you will see much more carriage, especially of C-SPAN II, which carries the Senate.

Senator METZENBAUM. C-SPAN II, my guess, is not carried in three areas in Ohio. My opinion is that anything that can produce revenue gets a channel slot. And C-SPAN, which is a public service and which is very much watched by many people who want to watch it, to see really what their public officials are doing, they do not have an opportunity to do so.

I do not think you can get it in Washington, as a matter of fact, unless you pick up 56, which I think is Baltimore or some place.

Mr. MOONEY. Cable in Washington is still under construction. I think the fact that the House is on in more places in the Senate is simply an accident of which body went first in allowing television in. But I think also that your comments in this forum will further help and encourage cable systems to put both of these services on, as I think they should be.

Senator METZENBAUM. We will give you extra time for my having taken yours. [Laughter.]

Mr. MOONEY. The point I am trying to make however, in general, is that cable has had to invent its own programming. If we had not gone ahead with services like Nickelodeon, which is children's programming, and C-SPAN which we have discussed at some length, and Black Entertainment Television, and other of what might properly be described as specialty channels, it is highly unlikely that anyone else would have stood up on the outside and put up the risk capital to invent these services.

But we had to. For if we did not distinguish ourselves from free television, we were not going to get too far.

Cable today, as has been said, is of course a much different phenomenon than was the case 10 years ago. Yes, we do now serve slightly more than 50 percent of all TV households. We wish that we served a higher percentage, however, and indeed a higher percentage than just the 57 percent of households which are able to take cable and actually do.

This is going to spur and drive further investment in programming, so we can bring even more and especially better alternatives to the public and persuade that other 43 percent who do not sign up to do so.

I was interested to hear Mr. Kocian, on the former panel, say "keep cable out of programming." If you did that, there would not be half as much cable programming as there is.

Many people believe that the Cable Act totally deregulated the industry, but this is far from accurate. It is true, we did win rate deregulation, but Congress also confirmed the authority of local governments to decide how many cable companies may operate within a given franchise area.

Senator METZENBAUM. Is that not totally unrealistic? How many communities in this country have duplicative services or competitive services in the same area?

Mr. MOONEY. Senator, the point I am trying to make is that it is entirely within the jurisdiction and discretion of city councils to decide how many franchises they want to grant in a given area.

Senator METZENBAUM. Mr. Mooney, I have to tell you. Some of us feel that we were had when we passed that bill. I think that, as I said in my opening statement, as loudly and as clearly as I can, this Congress in my opinion is ready to reexamine that whole issue, particularly with rates and with respect to availability of programming. I cannot say it loudly enough.

Mr. MOONEY. We are sensitive to your concerns about that, Senator. I wish I had more than 5 minutes, so I could get it all out on rates.

Senator METZENBAUM. I am going to come back to rates in my question, so you will have a chance.

Mr. MOONEY. Shall I pass rates, now? I am going to pass over rates.

Senator METZENBAUM. Give me a summary.

Mr. MOONEY. The summary is that we commissioned Arthur Anderson to do a study of what happened to rates in the cable industry during the first 6 months of 1987 and, to my knowledge, that is still the most recent information available. The Anderson study shows that while the average basic rate increased by 10.6 percent during the first 6 months of 1987, the average rate for premium services declined by 2.3 percent with the result that the average net subscriber bill increased by only 6.7 percent.

These findings are confirmed by the Bureau of Labor Statistics figures, which show average net cable rates up by only 6.6 percent from 1986 to the end of 1987, and by similar studies conducted by Kagan Associates, the media analyst firm.

[Material submitted by Mr. Mooney follows:]

# TESTIMONY OF JAMES P. MOONEY, PRESIDENT & CEO, NATIONAL CABLE TELEVISION ASSOCIATION, BEFORE THE SUBCOMMITTEE ON ANTITRUST, MONOPOLIES, AND BUSINESS RIGHTS, COMMITTEE ON THE JUDICIARY, UNITED STATES SENATE, MARCH 17, 1988

Mr. Chairman and members of the Subcommittee, my name is James Mooney and I am president of the National Cable Television Association (NCTA). NCTA is the principal trade association of the cable television industry and represents over 2,700 cable systems serving more than 80% of the 45 million cable homes in the United States. We also represent 56 cable programming services which create, package and provide quality TV programming for cable subscribers.

I will confine my prepared statement to two points: a nutshell history of cable's development as a television medium, and a brief report on the industry's performance subsequent to the passage of the Cable Communications Policy Act of 1984. During the question period, of course, I will be happy to answer any questions touching these or other topics the Subcommittee may wish to raise.

Cable television has its origins as a community antenna service designed to bring broadcast signals to rural areas outside the ordinary range of conventional broadcast transmitters. With the development of satellite communications, however, there arose the possibility of developing nationally distributed made-for-cable programming networks which could easily be provided to cable systems across the country.

The cable industry's interest in developing such services is easy to understand. If cable was to become more than a rural phenomenon, and do business in heavily populated areas where free, over the air broadcast transmissions were easily available, we would have to offer something more than a community antenna service. We would have to offer alternative television programming sufficiently attractive and different from what was available free, off-air to convince the public that cable service was worth the monthly subscription fee.

Thus Time, Inc. in 1975 launched satellite distribution of its HBO sports and movie service, a service it previously distributed primarily over its Manhattan cable system. Within three years HBO had over two million subscribers on over 700 cable systems, and the pay TV era was born.

Similarly, in 1978 Viacom, a major cable operator, began satellite distribution of the Showtime movie service as an alternative to HBO. Viacom subsequently acquired both MTV and Nickelodeon, networks devoted to music videos and children's programming, respectively, both of which at the time were financially uncertain, but showed great promise as alternative TV formats.

To take another example, in 1979 a group of cable operators created an entirely new public affairs network unique to cable. This, of course, is C-SPAN, the non-profit service which transmits gavel to gavel, unedited and uncommented-on proceedings of the House and Senate as well as other events of public importance.

All of these are primary examples of how the cable industry's own growth imperatives led it to create new forms of television to offer to the viewing public. Vertical integration, however, is not the only form in which cable programming has developed. ESPN, the sports network serving virtually every cable home is owned by ABC/Cap Cities, a major broadcast company. USA Network, which reaches over 90% of cable homes, is owned by Universal and Paramount, two major movie studios. The Disney Channel, which is the fastest growing of the premium services, is owned by another major studio.

In any event, the world of television has been unalterably changed by cable. In 1975, when HBO was launched on satellite, "television" to most people meant ABC, CBS and NBC, which among them garnered about a 90% share of all viewing. Today, however, television means cable, too, and in households which take full cable service, including one of the premium channels, the cable networks actually get more viewing in all day parts than the three broadcast networks put together. To the degree that the breadth of choice the American society gets from television has been enlarged, cable has been responsible for it.

Public policy has a way of catching up to such developments, of course, and in 1984 Congress enacted the Cable Communications Policy Act to bring some order to the regulatory landscape in which cable has to live.

Many people believe that the Cable Act totally deregulated the industry, but this is far from accurate. It's true that we did win rate deregulation, a decision we believe reflected Congress' understanding that basic rates had been artificially held down while premium rates had been pushed up too high. But Congress also confirmed the authority of local governments to decide how many cable companies may operate within a given franchise area, to impose a licensing fee of up to 5% of gross revenues, to require cable operators to set aside channels for public, educational and government use, to support public access studios, to establish physical plant requirements, to prohibit redlining, and to consider signal quality, an operator's response to consumer complaints, billing practices and other criteria in deciding whether to renew an operator's franchise. We also are subject to special statutory EEO and privacy requirements.

These regulatory restraints are unique to cable in the video world, and some of them are unique to cable in the world of American business generally.

The Act is still new -- it took full effect only 15 months ago -- and much of it has not yet been interpreted by the courts.

In a general sense, however, we believe the Act is working well. Cable rates have not skyrocketed since deregulation occurred at the end of December, 1986; indeed, a study done for us by Arthur Anderson shows that while the average basic rate increased by 10.6% during the first six months of 1987, the average rate for premium services declined by 2.3%, with the result that the average net subscriber bill increased by only 6.7%. These findings are confirmed by the Bureau of Labor Statistics' figures, which show average net cable rates up by only 6.6% from 1986 to 1987, and by similar studies conducted by Kagan Associates, the media analyst firm.

Several other developments also are noteworthy:

- In 1987 the industry's investment in plant rebuilds was up by more than a third over the amount spent in 1984, and spending for new subscriber equipment doubled over the same period. The stability provided by the Cable Act is in important factor in this increased investment.

- Our disconnect rates are down somewhat from their 1986 levels, while penetration of the premium services is up, presumably reflecting price decreases for these services.

- A recent national survey of cable subscribers by The Barna Research Group concluded that the one aspect of cable subscription with which most people were "very satisfied" was the customer service they receive. Another national survey by Magid Associates found that 78% of cable subscribers think "they're getting their money's worth." Even a survey by the National League of Cities (with which we have some problems) showed that 80% of the cable regulatory officers responding believe that customer satisfaction with cable service has either stayed the same or increased since passage of the Act.

Mr. Chairman, we don't take the position that cable is perfect or that we don't have any problems. It will be clear, too, as this hearing proceeds, that not everyone is pleased by cable's increasingly important role in the world of television. We do hope, however, that one fundamental point is not lost in the welter of controversy the communications industries frequently find themselves in. That fact is that cable has made a positive difference in the way this society uses television. Moreover, now that we have completed our great construction period, more and more money is going into programming. Cable operators are taking part of their cash flow and plowing it back into new programming to further make good on the promise of our medium. We think that's good for our industry, but more to the point, we believe it's good for the television viewing public as well.

National Cable Television Association

James P. Mooney
President &
Chief Executive Officer

1724 Massachusetts Avenue, Northwest
Washington, D.C. 20036
202 775 3655

April 8, 1988

The Honorable Howard Metzenbaum
Chairman, Subcommittee on Antitrust, Monopolies
   and Business Rights
Committee on the Judiciary
U.S. Senate
Washington, DC 20510

Dear Senator Metzenbaum:

In the course of the March 17, 1988 hearing on the cable industry held by your Subcommittee on Antitrust, Monopolies and Business Rights, several issues were raised which I was either specifically asked to respond to for the record or which I believe need additional explanation to complete the record. These issues are:

1) Allegations made regarding Coaxial Communications' (Columbus, Ohio) carriage of a Chillicothe, Ohio independent broadcast station;

2) Inquiries made regarding the number of cable systems in Ohio that carry C-SPAN and C-SPAN II;

3) Reference made to a list of cable systems which allegedly increased their rates by 50 percent or more during 1987;

4) Questions concerning satellite dish owners' access to cable programming; and

5) Concerns regarding cable systems' investment in cable programming companies (vertical integration).

## 1. Columbus/Chillicothe Situation

Joel S. Rudich, President and Chief Operating Officer of Coaxial Communications, recently responded in a detailed letter to you to questions regarding Coaxial's carriage of WWAT-TV, Chillicothe, Ohio. I have attached this letter, which I believe clarifies the facts, and ask that it be included in the hearing record. (See attachment I). As Mr. Rudich's letter explains WWAT had never been a must carry signal and carriage of WWAT would create a substantial copyright liability for Coaxial that WWAT acknowledges but fails to address satisfactorily.

## 2. C-SPAN and C-SPAN II Affiliates in Ohio

In addition, Brian Lamb, Chairman and Chief Executive Officer of C-SPAN, also recently wrote to you regarding your inquiry about the number of C-SPAN and C-SPAN II affiliates in Ohio. Again, I would respectfully ask that this letter and information, which is attached, be included in the hearing record. (See attachment II).

## 3. Cable Systems with Alleged Rate Increases of 50 Percent or More

During the hearing, reference was made to a list of 93 cable systems that had increased rates by 50% or more in 1987. This list was culled from ten different issues of Paul Kagan's Cable TV Franchising News Roundups. Kagan's News Roundups catalogue rate increases that are mentioned in press clippings that Kagan Associates receives from a press clippings service.

Although there has not been sufficient time to verify every instance on the list, we have reviewed this list and have several observations regarding how well it represents the pricing changes that have taken place since deregulation of cable rates went into effect nationally on January 1, 1987. First, this list does not in fact reflect 93 systems. At least thirteen of the 93 increases on the list are duplicates in so far as the same system is listed twice (such as Denver, where the price increase for two different tiers are listed), or multiple communities served by the same system are listed.

Second, in a number of the remaining 80 instances cited on the list, the rates did not increase either by the amount or the percentage stated on the list. For example, the cable system serving Norwich, CT was cited in this list as having increased basic rates by 116% in 1987. In fact, the system did increase its basic rate from $9.18 to $10.10 as stated on the list, but this increase only constitutes a 10% increase in basic rates not a 116% increase as stated in the list. As another example, the rate increase for the cable system in Sonora, CA appearing on the list occurred in May 1986, seven months before deregulation went into effect nationally. Moreover, the system increased its basic rate in May 1986 from $9.75 to $12.87 (not to $16.75 as stated on the list).

Third, in many instances, the basic rate increase was accompanied by a tier consolidation, and the subscribers involved experienced either a price reduction or service expansion after deregulation. According to the list, the cable system serving Denver, CO raised its basic rates by 458%, from $2.50 to $13.95 in 1987. A more thorough examination of the system's rate increase shows that 75% of the system's 55,000 subscribers actually received a $1.00 price decrease in 1987. Prior to deregulation, the system offered its subscribers three tiers of service, the "Community" tier with all local broadcast stations plus four cable channels for $2.50 per month; the "Budget" tier with all local broadcast stations plus ten cable channels for $7.95 per month; and the "Summit" tier, the choice of 75 percent of the system's subscribers, with fifty-four channels of local stations and cable channels for $14.95 per month. In 1987, the system collapsed these tiers into a single fifty-four channel tier with the same offerings as the $14.95 Summit tier and reduced the rate to $13.95 per month -- a $1/month reduction for 75 percent of the system's customers.

Finally, in almost every circumstance, basic rate increases tell only part of the story of rate deregulation. For example, although the cable system in Ocean City, MD raised its basic rate from $8.75 to $13.95 after deregulation (not from $6.85 to $13.95 as stated on the list), the system did so only after it upgraded its system from 22 channels to 60 channels and after it reduced the prices of its premium networks by 9.1%.

NCTA researched thoroughly as many of the rate increases as time allowed before the hearing record was to close. A summary of the systems we have analyzed to date is attached (see attachment III) and I would ask that this summary be included in the hearing record. We will provide you with additional information once our review has been completed.

I would again emphasize Mr. Chairman, as I did during your hearing, that three separate analyses of cable rate increases have concluded that the average net increase for consumers during 1987 has been substantially less than claimed by our critics. A nationwide sample that Arthur Andersen & Company conducted for NCTA found that the net increase in the average subscriber's total monthly bill was 6.7 percent from December 1986 to June 1987. Bureau of Labor Statistics' figures show average cable rates rose 5.3 percent over the same time period and a recent study by Kagan Associates revealed an average 5 percent increase in the average subscriber's monthly bill for the first nine months of 1987. While basic rates have indeed increased, as the 1984 Cable Act assumed they would after years of artificial restraint due to municipal rate regulation, premium network rates have decreased. Moreover, these basic rate increases have been accompanied, as the examples on the list of systems raised during the hearing illustrate, by increases in the number of channels offered, as well as by major investments by cable operators in plant and equipment and programming.

I would also acknowledge, however, that there have been systems that have raised their rates substantially above the national averages. But, on balance, I believe that these systems represent a small percentage of the more than 7,800 cable systems in the nation.

4. Satellite Dish Owners' Access to Scrambled Cable Programming

Several statements made at the hearing supported the need for legislation that would regulate the distribution, and ultimately the pricing, of scrambled cable programming. NCTA believes, for several reasons, that such legislation is not necessary. First, dish owners have access to scrambled satellite cable programming at fair and reasonable prices. The Senate Commerce Committee report on S. 889 finds that "scrambled signals of cable programming are being made available to dish owners at prices comparable to those being charged cable subscribers."

In addition, the Federal Communications Commission's January, 1988 quarterly progress report on scrambling concludes that programming is available to dish owners at prices comparable to or less than the prices cable subscribers pay. And, according to data from independent cable industry sources, the average price of basic cable service in 1987 was $12.69 per month, and the average rate for basic cable plus one premium network was $22.02. By comparison, according to information published by the satellite dish industry, the basic cable package offered to dish owners by Viacom Satellite Network is available for as little as $10 per month, and the cost of a basic service package plus one premium network is as little as $16 per month.

Second, dish owners can receive all the major cable networks that have been scrambled. In just over the past two years several networks delayed their scrambling plans until a mechanism was in place through which dish owners could subscribe to those services. There also are about 100 services that are not scrambled and are available to dish owners at no cost, including nearly 50 cable networks that offer programming that cable subscribers must pay for.

Additionally, the initial temporary decoder shortage, created largely by an unanticipated surge in demand for decoders, is over. At the end of June 1987, there were 183,050 authorized Videocipher II decoders. By year end there were 310,736 authorized Videocipher IIs, an increase of nearly 70 percent in six months. General Instrument, the firm that owns the rights to the Videocipher II technology, now has the production capacity in place to manufacture 100,000 decoder modules per month.

With the market working effectively legislation at this point would represent an unprecedented intrusion by the federal government into an industry's distribution and marketing practices. In the absence of evidence of misconduct or harm to consumers, this is contrary to the principles on which the American economic system is built. NBC-TV has the right to decide who will carry its signal in the local market, just as Chevrolet has the right to choose who distributes its cars in each city. And the government does not tell J.C. Penney who will distribute its products.

Pending legislation would primarily serve the interests of those who want the federal government to create and sanction a new line of business - third party distributors of satellite signals. The fact that scrambled programming is available to dish owners at prices equal to or less than cable customers, the fact that dish owners can buy all scrambled programming, and the fact that dish owners can buy programming in numerous packages from several sources have all been acknowledged. In other words, consumers are not being harmed. But some businesses (who want distribution rights for cable programming but have been unable to obtain those rights), are urging Congress to put them into business. This legislation, therefore, now seems primarily designed to support a group that wants a federally mandated right to be programming distributors.

It is difficult to understand how requiring additional middlemen, who will have to take their profit out of the consumer's subscription fee, will result in lower prices for consumers when most of the programmers are already selling directly to consumers at prices comparable to or less than prices to cable subscribers.

5. Cable Systems' Investment in Cable Programming Services

During the hearing several critical comments were made regarding vertical integration in the cable industry which I wanted to address for the record.

In discussing the issue of vertical integration in the cable industry -- that is, the investment by cable operators in cable programming — it is important to be very clear about exactly what vertical integration means, particularly from the perspective of television viewers. Historically the cable industry has had to invest in and create its own programming because the traditional broadcasters seldom departed from their standard fare of sitcoms and cops and robbers. In order to meet the goal of offering cable viewers greater choice and improved quality in programming, cable began investing in programming.

Today, cable's investment in its own programming has produced a rich and varied menu for American television consumers. For television viewers, cable's vertical integration means:

- o Nickelodeon -- quality programming for children, an audience that commercial broadcasters have basically abandoned, as this Subcommittee knows.

- Black Entertainment Network -- the only 24-hour national black entertainment network.
- C-SPAN and C-SPAN II — the cable industry-supported public affairs channels that provide unique coverage of the U.S. Congress, as well as a wide range of public policy-related events.
- Bravo -- a network devoted to award-winning domestic and foreign films and performing arts specials ranging from opera to jazz.
- The Discovery Channel -- an all science and nature documentary channel which was preserved due to cable operator investments.
- Cable News Network (CNN) — the pioneering all-news network that now sets the standard for news reporting.

In each of these and other instances, the cable industry's vertical integration has provided television viewers with programming choices, choices generally not otherwise available.

Although vertical integration, until the 1930s, had been viewed as primarily harmful to competition, it has become widely accepted in legal, economic, and regulatory circles that vertical integration entails both costs and benefits to competition, and that vertical integration must be judged in terms of its net economic benefit.[1] The costs of vertical integration can be increased market share, which may have the effect of making competitors' market entry or growth of their market shares more difficult. The benefits of vertical integration can be certain efficiencies that can lead to more product at lower cost.

An examination of the cable programming marketplace indicates that vertical integration by the cable industry has not erected barriers to entry by non-operators and that competition among programming services has been enhanced due to the increasing number of networks vying for channel capacity.

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[1] See Irwin M. Stelzer and Richard Schmalensee, "Potential Costs and Benefits of Vertical Integration," 52 Antitrust Law Journal, Summer 1983, pp. 249-259.

(1) Programming Options Have Increased

In January 1985, when the Cable Act took effect, there were forty-three satellite-delivered video cable services. Today, as the following table demonstrates, there are sixty such services, a 40 percent increase over the number in 1985. This figure includes attrition of some cable networks that are no longer in business. There have been twenty-seven new networks started up since January 1985. In addition, at least a dozen more services are in various stages of development and should be available to customers in the near future.

(2) Cable Operator Investment Has Not Deterred Development of Networks Without Such Investment

As the following table also indicates, of the 95 national, regional, or planned cable networks, 37, or 39 percent, have or will have no operator ownership involvement whatsoever. Three of the five largest (based on subscription counts) networks — ESPN, USA Network, and CBN Cable Network — have no operator investment. And other popular, widely available networks, such as The Disney Channel and The Nashville Network also have no cable operator investment. (Two of these networks, USA and Disney, are owned by movie studios and one, ESPN, by a broadcast network.)

CABLE PROGRAMMING NETWORKS
NUMBER OF NETWORKS WITH OPERATOR OWNERSHIP/EQUITY
AND WITHOUT OPERATOR OWNERSHIP/EQUITY

| | Total Number of Networks | Total Number of Networks With Operator Ownership/Equity | Total Number of Networks With No Operators Ownership |
|---|---|---|---|
| National | 60<br>(100%) | 35<br>(58%) | 25<br>(42%) |
| Regional | 23<br>(100%) | 14<br>(61%) | 9<br>(39%) |
| Planned | 12<br>(100%) | 9<br>(75%) | 3<br>(25%) |
| TOTAL | 95<br>(100%) | 58<br>(61%) | 37<br>(39%) |

As the numbers further demonstrate, of the sixty nationally delivered cable video networks, twenty-five, or 42%, have no ownership affiliation whatsoever with the operating side of the cable industry. Moreover, nine, or 39%, of the twenty-three regional programming networks function with no operator ownership involvement. In addition, of the twelve programming networks that are scheduled to be launched, three, the Preview Network (Penny Stock News), Wingtips (Global Broadcasting) and YOU TV (Health TV Corporation), are proceeding with no plans to attract operator investment.

Further evidence that vertical integration has not foreclosed entry into the programming marketplace is the fact that seven, or 26 percent, of the twenty-seven national programming services that have been launched since January 1985, such as SCORE, have done so with no operator involvement.

## Conclusion

To the degree that the breadth of choice the American society gets on television has been enlarged and that there is diversity of programming available to consumers, cable has been responsible for it. Cable has made a positive difference in the way this society uses television and now that we have completed our great construction period, more and more money is going into programming and the difference will become even greater. Cable operators are taking part of their cash flow and plowing it back into new programming to further make good on the promise of our medium.

As Jeff Greenfield wrote recently in TV Guide, "In one key sense, cable has made it possible to deliver fare that could not find a place on broadcast outlets, but that is immensely appealing to minority audiences. Taken together, those minorities add up to millions of viewers for whom cable has become a leisure time lifeline." Or as John O'Connor of The New York Times wrote, "The increase in the quantity of commendable programs [on cable] is little short of startling."

We think that's good for our industry, but more to the point, we believe it's good for the television viewing public as well.

I want to thank you, Mr. Chairman, for including this information as part of the March 17, 1988 hearing record and allowing NCTA to present this additional information and analysis regarding issues and concerns raised at the hearing.

Sincerely,

James P. Mooney

James P. Mooney

Attachments

Attachment I

Coaxial
Communications

Technology and Service through Cable Television

**Executive Offices**

March 22, 1988

Senator Howard Metzenbaum
1240 East 9th Street
Cleveland, Ohio 44199

Dear Senator Metzenbaum:

My name is Joel S. Rudich. I am the President and Chief Operating Officer of Coaxial Communications. Coaxial is an Ohio based cable television company employing approximately 300 people and servicing approximately 75,000 households in the Columbus and Cincinnati metropolitan areas.

On Thursday, March 17, 1988, you chaired a public hearing that dealt with several cable issues. One of these issues dealt with the carriage of independent broadcast signals on cable systems, and one of the panelists, Mr. Wendell Triplett, General Manager, WWAT-TV53, Chillicothe, Ohio, used this forum to unfairly disparage the name of our company, Coaxial Communications.

Unfortunately, Mr. Triplett misstated the facts regarding his signal not being carried on Coaxial's Columbus, Ohio cable system. Because Mr. Triplett's statements are so overwhelmingly inaccurate, I hereby request the opportunity to set the record straight since the Committee did not hear the real facts. I respectfully request that this letter and attachments be included in the record of the hearing.

In his testimony, Mr. Triplett dwelt on his investment in his new UHF broadcast station. Yet, at the same time, Coaxial made a major investment and took a sizeable risk to offer new local Columbus oriented programming and minority and special interest programming.

During 1986/1987, Coaxial spent several million dollars to expand the capacity of its Columbus system by adding five additional channels. At that time, it was our plan to add the following additional programming during the fall of 1988: The Discovery Channel, Black Entertainment Network, The Weather Channel, Electronic Program Guide and "Coax 36", a composite program channel including local Columbus area high school, college and professional sports. Contract negotiations with all these program suppliers had begun well before the anticipated 1987 fall launch of these new services.

While we were finalizing our fall marketing plans, we were formally notified by Mr. Triplett that his new station, WWAT-TV53, Chillicothe, which, as you know, is located approximately 50 miles south of Columbus, was a "must-carry" station and demanded carriage on our cable system. At that time, acting in good faith, we took Mr. Triplett at his word that, in fact, WWAT-TV53 was a "must-carry" signal even though they were not a "local" Columbus signal and their programming was nothing more than 24 hours a day of shopping from America's Value Network. We began carrying WWAT as part of the Basic Service on our cable system on October 1, 1987.

In December, 1987, when the U.S. Appeals Court overturned the "must-carry" rules, I personally contacted the local broadcast stations (both VHF and UHF) and informed them that, despite the court's decision, Coaxial had no plans to make any changes to our channel line-ups that would adversely affect them in any manner whatsoever. Indeed, we continued to carry TV53 into 1988.

However, on January 20, 1988, Coaxial was informed by its FCC counsel that, contrary to Mr. Triplett's claims, WWAT-TV53 was not, and had never been a must-carry signal under the FCC rules. In fact, carriage of WWAT would cause Coaxial to incur significant potential copyright liability which could range between $180,000 and $700,000 per year since WWAT-TV53 was a "distant" signal under the cable copyright law.

Upon learning of WWAT-TV53's erroneous representations, Coaxial dropped WWAT from carriage on its cable system; and, we informed Mr. Triplett, in writing, of the financial exposure to Coaxial. Mr. Triplett then advised Coaxial that Channel 53 would assume total copyright liability. However, his assumptions as to the copyright fees grossly underestimated the amount that Coaxial would be liable for.

Since that time, Coaxial Communications has made repeated attempts to have Mr. Triplett clarify his assumption of copyright liability. Contrary to Mr. Triplett's testimony that WWAT would cooperate fully to protect Coaxial the attached letters from me to WWAT-TV53 clearly show that this statement is absolutely inaccurate. These letters represent only a few of the unanswered letters sent to WWAT-TV53 seeking clarification.

Senator Metzenbaum, as you know, the copyright laws specify that the carriage of any distant signal (regardless of whether it is for one minute or for one month in any six-month accounting period) imposes significant copyright liability on a cable company. As a result of this law, the carriage of WWAT would impose a minimum $180,000 annual increase in copyright liability. As Coaxial grows, this payment could increase to approximately $700,000 annually. Thus, it is critical that we obtain from Mr. Triplett guarantees that he would make specific arrangements to deposit the funds reimbursing us for this expense incurred solely due to the carriage of WWAT. Coaxial will suffer this huge liability from the carriage of WWAT-TV53 regardless of whether Mr. Triplett is unable to reimburse us after carriage is instituted. We have simply requested Mr. Triplett insure that the station pay these costs. But, contrary to his testimony, the attached letters clearly show that Mr. Triplett acknowledges the copyright liability that WWAT-TV53 would impose on Coaxial and that he has refused to respond to this issue.

To the extent Mr. Triplett got bad advice regarding WWAT-TV53's must-carry status in Columbus, the bottom line is that TV53 was never a must-carry signal under FCC rules. In fact, WWAT-TV53, as a distant station under the copyright law, imposed major potential copyright liability on Columbus cable systems. Having relied on Mr. Triplott's earlier erroneous statements regarding his must-carry status, Coaxial now wants more than empty, ambiguous and unenforceable statements that the station will take care of us.

In summary:

1) WWAT is not and has never been a must-carry signal for Coaxial Communications.

2) Carriage of WWAT by Coaxial Communications would create a copyright liability of $180,000 to $700,000 for Coaxial

3) Mr. Triplett has continually refused to respond to Coaxial's request regarding insuring Coaxial protection from the copyright liability related to WWAT's carriage.

4) Coaxial currently carries all local signals carried under the recently overturned must-carry rules and we have no plans to do otherwise. I personally contqcted these local stations in December, 1987 and informed them of this fact.

Senator Metzenbaum, I trust this provides both sides of the story regarding the signal carriage of WWAT on Coaxial's Columbus, Ohio cable system. Mr. Triplett hoped to guarantee his success in the broadcast business based on his Chillocothe signal being carried on the Columbus cable systems 50 miles away regardless of the nature of the copyright laws. He did not fully understand the laws regarding cable's copyright liability in carrying distant independent signals. As such, it is not accurate to blame Coaxial for Mr. Triplett's mistake. Coaxial has acted in complete good faith in its efforts to accommodate the carriage of WWAT.

I look forward to meeting with you on your next visit back home to either Cleveland or Columbus. In the meantime, if I can be of any further assistance to you on this matter, please let me know.

Sincerely,

Joel S. Rudich
President and
Chief Operating Officer

/gg

Enclosures

cc: Preston Padden, President, INTV

Attachment II

C-SPAN
Suite 412
444 North Capitol Street, N.W.
Washington, D.C. 20001
202/737-3220

March 18, 1988

Senator Howard Metzenbaum
U.S. Senate
140 Senate Russell Office Building
Washington, DC 20510

Dear Senator Metzenbaum:

Amos Hostetter, chairman of Continental Cablevision, asked me to write you on his behalf concerning the number of C-SPAN and C-SPAN II affiliates in Ohio.

According to our records 26 cable television systems, serving almost 600,000 households, have access to Senate proceedings via C-SPAN II in Ohio. That represents 30% of the cable television households in Ohio. Among those communities with C-SPAN II are Akron, Cincinatti, Cleveland, Dayton, Parma and Kettering. I've attached our most current list of C-SPAN II affiliates in Ohio for your reference. In addition, three more Ohio cable systems are planning to add C-SPAN II in the next four months.

In the case of C-SPAN, which cablecasts the House of Representatives and other public affairs programming, 167 cable systems with almost 1.6 million subscribers, carry the service. Those figures represent 82% of all cable households in Ohio including almost all the major cities in the state. Our list of those affiliates is also attached.

I hope this clarifies the situation in Ohio. Please let me know if you require any additional information.

Sincerely,

Brian P. Lamb
Chairman & CEO

cc: Amos Hostetter

THE CABLE SATELLITE PUBLIC AFFAIRS NETWORK

Page No. 1
03/13/88

C-SPAN

Marketing List

| No. | MSO Name | Principle Community | St | Subs. | Tier Subs |
|---|---|---|---|---|---|
| ** Sort Key1 ===) OH | | | | | |
| 1162 | WARNER | AKRON | OH | 72524 | 0 |
| 1235 | POST-NEWSWEEK | AKRON SUBURBS/SUMMIT COUNTY (SOUTH) | OH | 10365 | 8019 |
| 1816 | TRIAX COMMUNICATIONS | ALLEN COUNTY | OH | 905 | 0 |
| 2714 | CONTINENTAL | AMHERST | OH | 2500 | 0 |
| 1204 | COONEY CABLE ASSOCIATES | ANNA | OH | 1705 | 0 |
| 2602 | TCI | ARMAGH | OH | 1564 | 0 |
| 2452 | ARMSTRONG UTILITIES | ASHLAND | OH | 6547 | 0 |
| 1163 | TCI | ASHTABULA | OH | 12433 | 3358 |
| 1164 | CONTINENTAL | ATHENS | OH | 5119 | 0 |
| 1925 | ARMSTRONG UTILITIES | AUSTINTOWN | OH | 13563 | 0 |
| 1165 | CONTINENTAL | AVON LAKE/BAY VILLAGE | OH | 6050 | 0 |
| 2591 | TCI | BARNESVILLE | OH | 1550 | 0 |
| 1166 | COMPLEXICABLE OF CUYAHOGA | BATH/CUYAHOGA VALLEY | OH | 6412 | 0 |
| 1168 | FIRST AMERICABLE | BAZETTA TWP. (NEAR WARREN) | OH | 2143 | 0 |
| 1169 | SCOTT CABLE | BELLEFONTAINE | OH | 3900 | 0 |
| 1170 | CONTINENTAL | BELLEVUE | OH | 5514 | 0 |
| 2579 | TCI | BELMONT | OH | 617 | 0 |
| 1171 | SHAMROCK CABLE | BEREA | OH | 7011 | 0 |
| 1232 | ARMSTRONG UTILITIES | BOARDMAN | OH | 15554 | 0 |
| 2563 | TCI | BOLIVAR | OH | 1834 | 0 |
| 1936 | THREE SIXTY CORP/WOOD TV CORP. | BOWLING GREEN | OH | 6034 | 0 |
| 2332 | CENTEL | BRADFORD | OH | 178 | 0 |
| 2357 | HI-TECH CABLE SYSTEMS | BRATENAHL | OH | 254 | 0 |
| 1175 | COMPLEXICABLE MGMT. SERVICES | BRECKSVILLE | OH | 2133 | 0 |
| 2516 | TCI | BRIDGEPORT | OH | 2500 | 0 |
| 1173 | SHAMROCK CABLE | BROOK PARK | OH | 4033 | 0 |
| 1174 | SHAMROCK CABLE | BRUNSWICK | OH | 5000 | 0 |
| 2530 | TCI | CADIZ | OH | 1043 | 0 |
| 2560 | TIMES MIRROR | CALDWELL | OH | 1317 | 0 |
| 1176 | TIMES MIRROR | CAMBRIDGE | OH | 6736 | 0 |
| 1177 | WARNER | CANTON | OH | 56129 | 0 |
| 2072 | HERITAGE | CELINA | OH | 4665 | 0 |
| 1858 | CABLEVISION SYSTEMS | CHARDON | OH | 5203 | 0 |
| 1178 | METROVISION | CHEVIOT | OH | 1559 | 0 |
| 165 | MCDONALD GROUP | CHILLICOTHE | OH | 9000 | 0 |
| 1179 | WARNER | CINCINNATI | OH | 151019 | 133347 |
| 1180 | VIACOM | CLEVELAND | OH | 72309 | 0 |
| 2843 | VIACOM/NORTH COAST CABLE | CLEVELAND (NEW BUILD) | OH | 0 | 0 |
| 1184 | COX | CLEVELAND WEST SUBURBS/PARMA | OH | 43551 | 0 |
| 2565 | TCI | COLUMBIANA | OH | 2414 | 0 |
| 1187 | ATC | COLUMBUS | OH | 74000 | 27803 |
| 1185 | TELE-MEDIA | COLUMBUS | OH | 8315 | 0 |
| 1186 | WARNER | COLUMBUS | OH | 70506 | 57344 |
| 1188 | TCI | CONNEAUT | OH | 6170 | 0 |
| 2748 | TIMES MIRROR | COSHOCTON | OH | 6300 | 0 |
| 2078 | TCI | CRESTON | OH | 3070 | 0 |
| 2305 | METROPOLITAN SATELLITE CORP. | CUYAHOGA FALLS(PORTAGE TOWERS APTS) | OH | 100 | 0 |
| 1190 | VIACOM | DAYTON | OH | 41306 | 0 |

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## Marketing List

| No. | MSO Name | Principle Community | St | Subs. | Tier Subs |
|---|---|---|---|---|---|
| 2180 | TIMES MIRROR | DEFIANCE-BRUNERSBURG | OH | 5000 | 0 |
| 1131 | ATC | DELAWARE | OH | 1803 | 600 |
| 1192 | UNITED VIDEO | DELHI | OH | 8510 | 0 |
| 1635 | WARNER | DELPHOS | OH | 2047 | 0 |
| 2503 | TRIAX COMMUNICATIONS | DESHLER | OH | 761 | 0 |
| 634 | PHOENIX CABLE INC. | DUNKIRK/WAKEMAN/BERLINE HGTS. | OH | 500 | 0 |
| 1238 | TCI | EAST LIVERPOOL | OH | 8000 | 0 |
| 2585 | TCI | EAST PALESTINE | OH | 2033 | 0 |
| 1820 | TRIAX COMMUNICATIONS | EDON | OH | 143 | 0 |
| 1134 | CONTINENTAL | ELYRIA | OH | 25750 | 0 |
| 1935 | CONTINENTAL | ENGLEWOOD | OH | 16500 | 0 |
| 2307 | METROPOLITAN SATELLITE CORP. | EUCLID (RIVIERA APTS.) | OH | 40 | 0 |
| 2308 | METROPOLITAN SATELLITE CORP. | EUCLID (WATERGATE APTS.) | OH | 749 | 0 |
| 1195 | CONTINENTAL | FAIRBORN | OH | 15164 | 0 |
| 2596 | TCI | FAIRPORT | OH | 356 | 0 |
| 1196 | CONTINENTAL | FINDLAY | OH | 14817 | 0 |
| 2532 | TCI | FLUSHING | OH | 255 | 0 |
| 1197 | CONTINENTAL | FOSTORIA | OH | 11306 | 0 |
| 2735 | FREMONT CABLE | FREMONT | OH | 6163 | 0 |
| 2637 | WARNER | FT. SHAWNEE | OH | 7572 | 0 |
| 1198 | CONTINENTAL | GALION | OH | 3445 | 0 |
| 1199 | TCI | GENEVA | OH | 26532 | 0 |
| 1200 | TCI | GOLF MANOR | OH | 818 | 0 |
| 810 | GRAFTON CABLE COMMUNICATIONS | GRAFTON VILLAGE/WELLINGTON VILLAGE | OH | 1737 | 0 |
| 2212 | METROVISION | GREEN TOWNSHIP | OH | 11394 | 0 |
| 1900 | TIMES MIRROR | GREENFIELD | OH | 1321 | 0 |
| 1201 | TCI | HAMILTON | OH | 28511 | 0 |
| 2595 | TCI | HOLLOWAY | OH | 122 | 0 |
| 2594 | TCI | HOPE DALE | OH | 462 | 0 |
| 1202 | CONTINENTAL | HUBER HEIGHTS | OH | 16433 | 0 |
| 1203 | CABLEVISION SYSTEMS | INDEPENDENCE | OH | 1852 | 0 |
| 2581 | TCI | IRONDALE | OH | 100 | 0 |
| 1856 | STAR CABLE | JACKSONTOWN | OH | 500 | 0 |
| 2117 | TELECABLE | JEFFERSON TOWNSHIP | OH | 300 | 0 |
| 2593 | TCI | JEWETT | OH | 100 | 0 |
| 1922 | TCI | KENT/RAVENNA | OH | 15745 | 0 |
| 1636 | WARNER | KENTON | OH | 2850 | 0 |
| 1205 | TCI | KIRKERSVILLE | OH | 110 | 0 |
| 1206 | TCI | LAKE COUNTY (CONCORD TWP.) | OH | 12278 | 0 |
| 638 | SCOTT CABLE | LAKEVIEW/RUSSELL POINT | OH | 2079 | 0 |
| 2847 | TELE-MEDIA | LIBERTY/HILLSBORO | OH | 533 | 0 |
| 1207 | CENTEL | LIMA | OH | 20155 | 0 |
| 1918 | LANDMARK CABLEVISION ASSOCIATES | LISBON | OH | 1202 | 0 |
| 1710 | TIMES MIRROR | LOGAN | OH | 2335 | 0 |
| 2153 | CENTEL | LONDON | OH | 2613 | 0 |
| 1208 | ADELPHIA | LORAIN | OH | 12053 | 0 |
| 2442 | TRIAX COMMUNICATIONS | LUCKEY | OH | 651 | 0 |
| 1209 | ADELPHIA | MACEDONIA | OH | 2331 | 0 |
| 1217 | TCI | MAHONING VALLEY/NILES | OH | 21314 | 0 |

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Marketing List

| No. | MSO Name | Principle Community | St | Subs. | Tier Subs |
|---|---|---|---|---|---|
| 2358 | TIMES MIRROR | MARION | OH | 14018 | 0 |
| 2514 | TCI | MARTINS FERRY | OH | 4500 | 0 |
| 1211 | CENTEL | MARYSVILLE | OH | 2526 | 0 |
| 2513 | MASSILON CABLE TV | MASSILLON | OH | 13725 | 0 |
| 2309 | METROPOLITAN SATELLITE CORP. | MAYFIELD HTS. (GATES MILLS TOWERS) | OH | 234 | 0 |
| 1212 | CONTINENTAL | MENTOR | OH | 31130 | 0 |
| 1213 | TCI | MIDDLETOWN | OH | 20234 | 0 |
| 1921 | TCI | MINERVA | OH | 3000 | 0 |
| 70 | TCI | MINGO JUNCTION | OH | 4606 | 0 |
| 2582 | TCI | NEW MIDDLTON | OH | 833 | 0 |
| 1902 | TIMES MIRROR | NEW PHILADELPHIA | OH | 15250 | 0 |
| 1216 | TIMES MIRROR | NEWARK | OH | 21733 | 0 |
| 1832 | TIMES MIRROR | NEWCOMERSTOWN | OH | 2033 | 0 |
| 1218 | CONTINENTAL | NORTH OF DAYTON/ENGLEWOOD | OH | 16431 | 0 |
| 1219 | CABLEVISION SYSTEMS | NORTH OLMSTEAD | OH | 11035 | 0 |
| 1220 | CONTINENTAL | NORTH RIDGEVILLE | OH | 5363 | 0 |
| 2360 | CABLEVISION SYSTEMS | NORTH ROYALTON | OH | 2723 | 0 |
| 1618 | TRIAX COMMUNICATIONS | NORTHWOOD | OH | 1863 | 0 |
| 1222 | CONTINENTAL | NORWALK | OH | 28134 | 0 |
| 2832 | OBERLIN CABLE CO-OP | OBERLIN | OH | 237 | 0 |
| 1223 | OLMSTED CABLE CO. | OLMSTED TOWNSHIP | OH | 400 | 0 |
| 2533 | TCI | OREGON | OH | 4518 | 0 |
| 2156 | CENTEL | OTTAWA | OH | 5000 | 0 |
| 1719 | CENTEL | OXFORD | OH | 1780 | 0 |
| 1224 | CONTINENTAL | PAINESVILLE/MENTOR | OH | 4344 | 0 |
| 2569 | WORLD SATELLITE NETWORK | PARMA (KIMBERLY PARK APTS) | OH | 50 | 0 |
| 2305 | METROPOLITAN SATELLITE CORP. | PARMA (REGENCY APTS.) | OH | 213 | 0 |
| 1226 | METROPOLITAN SATELLITE CORP. | PARMA HEIGHTS | OH | 1434 | 0 |
| 2568 | WORLD SATELLITE NETWORK | PARMA HEIGHTS (RIDGEWOOD PARK APTS) | OH | 50 | 0 |
| 2310 | METROPOLITAN SATELLITE CORP. | PARMA HTS. (NORTH CHURCH APTS.) | OH | 75 | 0 |
| 2304 | METROPOLITAN SATELLITE CORP. | PARMA(MIDTOWN APTS.) | OH | 207 | 0 |
| 2070 | HERITAGE | PAULDING | OH | 812 | 0 |
| 1824 | TRIAX COMMUNICATIONS | PIONEER | OH | 137 | 0 |
| 1227 | CENTEL | PIQUA/ST. PARIS | OH | 7783 | 2832 |
| 1953 | WARNER | POWELL | OH | 81 | 0 |
| 1871 | TCI | RAVENNA | OH | 12500 | 0 |
| 2154 | CENTEL | RICHWOOD | OH | 750 | 0 |
| 1919 | LANDMARK CABLEVISION ASSOCIATES | SALEM | OH | 3300 | 0 |
| 1230 | ERIE COUNTY CABLEVISION | SANDUSKY | OH | 16404 | 0 |
| 2580 | TCI | SCIO | OH | 407 | 0 |
| 2515 | TCI | SHADYSIDE | OH | 1000 | 0 |
| 1231 | CABLEVISION SYSTEMS | SHEFFIELD LAKE | OH | 2013 | 0 |
| 1905 | WARNER | SIDNEY | OH | 5420 | 0 |
| 2361 | CABLEVISION SYSTEMS | SOLON/BEDFORD HEIGHTS | OH | 5647 | 0 |
| 1232 | CONTINENTAL | SOUTH OF DAYTON/KETTERING | OH | 54745 | 0 |
| 2340 | ARMSTRONG UTILITIES | SOUTH POINT | OH | 10065 | 0 |
| 1233 | CONTINENTAL | SPRINGFIELD | OH | 27054 | 0 |
| 2639 | WARNER | ST. MARYS | OH | 3115 | 0 |
| 125 | TCI | STEUBENVILLE | OH | 7648 | 0 |

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Marketing List

| No. | MSO Name | Principle Community | St | Subs. | Tier Subs |
|---|---|---|---|---|---|
| 2223 | CABLEVISION SYSTEMS | STRONGSVILLE | OH | 20003 | 0 |
| 1234 | CENTURY COMMUNICATIONS | STRUTHERS | OH | 3700 | 0 |
| 1815 | TRIAX COMMUNICATIONS | SWANTON | OH | 3225 | 0 |
| 1237 | CENTEL | TIPP CITY/W. MILTON | OH | 4500 | 0 |
| 1238 | COOKE CABLEVISION, INC. | TOLEDO (SUBURBAN) | OH | 3329 | 0 |
| 2331 | CENTEL | TROY | OH | 5850 | 0 |
| 2863 | TIMES MIRROR | UHRICHSVILLE | OH | 4632 | 0 |
| 2638 | WARNER | UNION CITY | OH | 1713 | 0 |
| 1240 | CONTINENTAL | UPPER SANDUSKY | OH | 2425 | 0 |
| 2071 | HERITAGE | VAN WERT | OH | 3028 | 0 |
| 1241 | ADELPHIA | VERMILION | OH | 2331 | 0 |
| 2636 | WARNER | WAPAKONETA | OH | 3452 | 0 |
| 2844 | TRIAX COMMUNICATIONS | WATERVILLE | OH | 5000 | 0 |
| 1901 | TIMES MIRROR | WAVERLY | OH | 2420 | 0 |
| 2441 | COONEY CABLE ASSOCIATES | WAYNESFIELD | OH | 516 | 0 |
| 1243 | CONTINENTAL | WILLARD | OH | 2270 | 0 |
| 2726 | MASSILON CABLE TV | WOOSTER | OH | 9312 | 0 |
| 1248 | CONTINENTAL | XENIA | OH | 8831 | 0 |
| 2155 | CENTEL | YELLOW SPRINGS | OH | 2650 | 0 |
| 1249 | WARNER | YOUNGSTOWN | OH | 18505 | 0 |
| 1250 | TCI | ZANESVILLE | OH | 17764 | 0 |
| | ** Subtotal ** | | | 1587368 | 237903 |
| | *** Total *** | | | 1587368 | 237903 |

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                                        C-SPAN II

                                     Marketing List
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 No. MSO Name                                    Principle Community                      St    Subs. Tier Subs
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** Sort Key1 ===) OH
1162 WARNER                                      AKRON                                    OH    72524         0
1235 POST-NEWSWEEK                               AKRON SUBURBS/SUMMIT COUNTY (SOUTH)      OH    10365      8819
2714 CONTINENTAL                                 AMHERST                                  OH     2500         0
1171 SHAMROCK CABLE                              BEREA                                    OH     3011         0
1336 THREE SIXTY CORP/WOOD TV CORP.              BOWLING GREEN                            OH     6034         0
1173 SHAMROCK CABLE                              BROOK PARK                               OH     4033         0
1174 SHAMROCK CABLE                              BRUNSWICK                                OH     5000         0
1179 WARNER                                      CINCINNATI                               OH   154050    135347
1180 VIACOM                                      CLEVELAND                                OH    72309         0
2843 VIACOM/NORTH COAST CABLE                    CLEVELAND (NEW BUILD)                    OH        0         0
1184 COX                                         CLEVELAND WEST SUBURBS/PARMA             OH    43551         0
1188 TCI                                         CONNEAUT                                 OH     6176         0
1130 VIACOM                                      DAYTON                                   OH    41335         0
1136 CONTINENTAL                                 FINDLAY                                  OH    14917         0
1202 CONTINENTAL                                 HUBER HEIGHTS                            OH    16437         0
2153 CENTEL                                      LONDON                                   OH     3613         0
  70 TCI                                         MINGO JUNCTION                           OH     4605         0
1218 CONTINENTAL                                 NORTH OF DAYTON/ENGLEWOOD                OH    16471         0
1213 CABLEVISION SYSTEMS                         NORTH OLMSTEAD                           OH    11035         0
2156 CENTEL                                      OTTAWA                                   OH     5000         0
2154 CENTEL                                      RICHWOOD                                 OH      700         0
1230 ERIE COUNTY CABLEVISION                     SANDUSKY                                 OH    16101         0
1232 CONTINENTAL                                 SOUTH OF DAYTON/KETTERING                OH    54745         0
 125 TCI                                         STEUBENVILLE                             OH     3640         0
1237 CENTEL                                      TIPP CITY/W. MILTON                      OH     4500         0
2155 CENTEL                                      YELLOW SPRINGS                           OH     2650         0
** Subtotal **
                                                                                                598302    144766
*** Total ***
                                                                                                598302    144766
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Attachment III

## DETAILED DESCRIPTION OF THE RATE CHANGES IMPLEMENTED BY CABLE SYSTEMS APPEARING ON SENATOR METZENBAUM'S MARCH 17, 1988 LIST

o Greenbelt, MD

According to the list, the system in Greenbelt, MD raised its basic rate from "free" to $7.95 in 1987. Although this pricing change took place, the system dropped the price of this tier in January 1988 by 62% to $3.00 and at the same time it added WWOR to the channels offered on this tier.

o Denver, CO (Duplicate: same system also appears later on list under Denver, CO)

According to the list, the cable system in Denver, CO raised its basic rates from $2.50 to $13.95 in 1987. More accurately, 75% of the system's subscribers received a $1.00 price decrease due to tier consolidation. Prior to deregulation, the system offered its subscribers three tiers of service, the "Community" tier with all local broadcast stations plus four cable channels for $2.50 per month; the "Budget" tier with all local broadcast stations plus ten cable channels for $7.95 per month; and the "Summit" tier with fifty-four channels of local stations and cable channels for $14.95 per month. After deregulation, the system collapsed these three tiers into a single fifty-four channel tier with the same offerings as the $14.95 Summit tier, and reduced the rate to $13.95 per month.

o Weston, CT (Duplicate: Same system also appears later on list under Weston, CT)

According to the list, the cable system in Weston, CT raised its basic rate from $4.90 to $19.95 in 1987. However, these two prices reflect two different tiers of service. Prior to deregulation, the Weston system offered two tiers of basic service. One tier, a 35-channel tier, cost $4.90 per month for subscribers with a cable-ready set, or $6.45 for subscribers who need to lease a converter. After deregulation, the price of this tier rose to $13.95 for subscribers who need to lease a converter.

The second tier of service, which was not created until March 1987, after deregulation, contained an additional seven channels and cost an additional $6 per month. Thus, subscribers who purchased both of these tiers paid $19.95 after deregulation.

In addition to these rate changes, the Weston system dropped the prices of ten premium networks by 31%, from $14.50 to $10.00. These premium networks are: HBO, Showtime, Cinemax, The Movie Channel, Disney, Playboy, Bravo, American Movie Classics, and the SportsChannel.

- Russell, OH

According to the list, the cable system in Russell, OH raised its rates from $5.00 to $16.00 in 1987. No such pricing change took place. The cable system did increase its basic service tier from $5.00 to $8.50 in January 1987. At the same time, this system reduced its "family" service (expanded basic) tier from $10 to $7.50. Therefore, subscribers purchasing the expanded tier experienced a 6.7% increase in basic rates from $15.00 to $16.00.

- Corvallis, OR (Duplicate: same system also appears on list under Albany, OR)

According to the list, the cable system in Corvallis, OR raised its basic rates from $6.05 to $15.00 in 1987. However, on March 1, 1987 the system combined a nine-channel tier priced at $6.05 per month with a seven-channel tier priced at $4.45 per month and added ten additional channels. Thus, subscribers to the second tier of service received 63% more channels after deregulation and subscribers to the first tier of service experienced a 189% increase in the number of channels they receive.

- Long Beach, CA

According to the list, the cable system located in Long Beach, CA raised its basic rate from $6.45 to $14.95 in 1987. On March 1, 1987, the system consolidated its "economy" tier of basic service into another basic service tier. This tier only contained the local off-air stations and public access channels. In fact, less than 2,200 of the system's 50,000 subscribers opted to take this tier of service. The tier was eliminated because the cost of offering this separate service was greater than the revenues generated by the economy tier subscribers. The remaining 48,000 basic subscribers were unaffected by this change.

- Norwich, CT

According to the list, the cable system in Norwich, CT raised its basic rates from $9.18 to $10.10 in 1987. In 1987, the system did indeed increase its basic rates from $9.18 to $10.10 as reported on the list. This rate increase represents, however, an increase of only 10%, not 116% as reported on the list.

- Ocean City, MD

According to the list, the cable system in Ocean City, MD raised its basic rates from $6.85 to $13.95 in 1987. No such pricing change took place. On October 1, 1987, this system raised its basic rates from $8.75 to $13.95. This was the system's first rate increase since the system completed its rebuild in 1986. At that time, the system spent $14 million to upgrade the system from a

22-channel one way system to a 60-channel two-way fully addressable system. Moreover, effective January 1, 1987, the system reduced its rates for premium network services by 8.4%, from $11.95 to $10.95.

- o Denver, CO  Duplicate: See Denver, CO

- o Sonora, CA

According to the list, the cable system in Sonora, CA raised its basic rate from $9.75 to $16.75 in 1987. The system, however, implemented no such increase, and has not changed its prices since May 1986. In May 1986, the system completed an upgrade of its system, expanding the channel capacity from 12 to 35 channels. At that time, the system raised the price of its 12-channel basic tier from $9.75 to $12.87. The system also created an additional 16-channel tier, priced at $4.08 per month.

- o Mundelein, IL (Duplicate: system also appears on list under Libertyville, IL)

According to the list, the system serving Mundelein, IL raised basic rates from $7.70 to $12.95. In actuality, on February 1, 1987, the cable system collapsed its $7.70 basic tier (36 channels) and its $4.95 expanded basic tier (6 channels) into a $12.95 basic service tier. The system also added SportsVision, previously a $9.95 per month premium network, and superstation WWOR to the basic tier of service. Therefore, subscribers purchasing the expanded basic tier prior to February 1, 1987 experienced only a 2.4% increase in price of basic service and received a premium network and a superstation as part of the basic package. Moreover, the system reduced its monthly rates for each of the five premium networks carried by the system. The price for HBO, Showtime and Cinemax were reduced by 9.5%, from $9.95 to $9.00, and the price for Disney dropped by 10%, from $10.00 to $9.00.

- o Acton, MA (Duplicate: same system appears on list under Hudson, MA and Hudson-Maynard, MA)

According to the list, the cable system in Acton, MA raised its basic rates from $4.50 to $7.50 in 1987. Although this system did in fact implement this price increase in 1987, the system decreased the rates for the expanded basic tier (10 channels) by 16.7% from $9.00 to $7.50. In addition, the number of channels on the basic tier increased by 8.7%, from 23 to 25 channels, and the number of channels on the expanded basic tier increased by 10% from 10 to 11 channels. Therefore, subscribers purchasing the expanded tier experienced only an 11.1% rate increase accompanied by a 9.1% increase in the number of channels available in 1987.

o Hudson, MA Duplicate: See Acton, MA

o Hudson-Maynard, MA Duplicate: See Acton, MA

o Buckland et. al, MA (Duplicate: same system also appears under Turner Falls, MA)

According to the list, the cable system serving Buckland, et. al, MA raised its rates from $8.25 to $13.95 in 1987. In actuality, on February 1, 1987, the system increased its rates for the basic tier of service (12 channels) by 12.1%, from $8.25 to $9.25. The system also increased the rates for the expanded basic tier (8 channels) by 1% from $4.70 to $4.75. On September 1, 1987, the system collapsed its basic and expanded basic tiers into one basic service tier (23 channels) priced at $13.95. Therefore, subscribers purchasing the expanded basic tier prior to January 1, 1987 experienced only a 7.7% increase in the cost of basic service but received 15% more channels. Moreover, the subscribers who purchased only the basic tier of service prior to January 1, 1987 experienced a 91.7% increase in the number of basic channels received, from 12 to 23 basic channels.

o Indian Lake, OH

According to the list, the cable system in Indian Lake, OH raised its basic rate from $8.00 to $13.00 in 1987. Although this system did implement this price increase in July 1987, the system had just completed a rebuild at an estimated cost of $3 million. The old cable plant was a 12-channel (11 basic and one premium network) system while new cable plant is a 30-channel system. Therefore, subscribers saw a dramatic increase in the number of basic channels. In fact, the number of basic channels increased by 136%, from 11 to 26 channels.

o Libertyville, IL Duplicate: See Mundelein, IL

o Lower Township, NJ (Duplicate: same system also appears under Wildwood, NJ)

According to the list, the cable system in Lower Township, NJ raised its basic rates from $8.40 to $13.50 in 1987. In actuality, on January 1, 1987, the system consolidated its $8.40 basic tier (12 channels) and its $6.00 expanded basic tier (8 channels) into one basic service tier (22 channels) priced at $13.50. Therefore, subscribers purchasing the expanded basic tier prior to January 1, 1987 experienced a 6.25% decrease in cost of basic service. Subscribers purchasing only the basic tier prior to January 1, 1987 experienced an 83.3% increase in the number of basic channels. Moreover, the system decreased its rates for three premium networks carried by the system. The price for HBO, Showtime, and Disney decreased by 28.7%, from $13.95 to $9.95, on an a la carte basis on January 1, 1987.

- Wildwood, NJ Duplicate: See Lower Township, NJ

- Troy, OH

According to the list, the cable system in Troy, OH raised its basic rates from $9.40 to $14.99 in 1987. On January 1, 1987, the system consolidated its $9.31 basic tier (23 channels) and its $4.70 (including converter) expanded basic tier (6 channels) into a single 32 channel basic tier priced at $14.99. Therefore subscribers purchasing the expanded basic tier experienced a 7% basic rate increase from $14.01 to $14.99. Moreover, the system also decreased its rates for three premium networks on January 1, 1987. The price for The Playboy Channel, for example, decreased by 23.2%, from $12.95 to $9.95. Likewise, the price for Disney decreased by 30.2%, from $9.95 to $6.95 and the rates for Showtime decreased by 9.1%, from $10.95 to $9.95.

- Walnut Creek, CA

According to the list, the cable system in Walnut Creek, CA raised its basic rates from $8.50 to $12.95 in 1987. The system, however, consolidated its tiers in February 1987. Prior to consolidation, the system offered a basic service package of 12 channels for $8.50, and an expanded tier of 10 additional channels for $5.00. After consolidation (which came after completion of system rebuild), the system offered a basic service of 29 channels for $12.95. Thus, the 45% of customers subscribing to the expanded basic tier actually received a price decrease of 4.1% (from $13.50 to $12.95) and an increase in the number of channels of 32% (from 22 to 29). Subscribers to the basic tier received a 142% increase in the number of channels (from 12 to 29). In addition, the price of HBO decreased 9.1% from $11.00 to $10.00, and multi-pay discounts were introduced.

- Turners Fall, MA Duplicate: See Buckland et. al, MA

- Weston, CT Duplicate: See Weston, CT

- Albany, OR Duplicate: See Corvallis, OR o Downs, IL (Duplicate: system also appears later on the list under Downs, IL)

According to the list, the Downs, IL cable system raised basic rates from $9.95 to $14.95 in 1987. Although this rate increase did take place in November 1987, the number of basic channels increased by 44% at the same time, from 9 to 13.

o Broadview, IL Duplicate: See Oak Park, IL

o Burnham, IL Duplicate: See Oak Park, IL

o Downs, IL Duplicate: See Downs, IL

o Oak Park, IL (Duplicate: same system also appears under Broadview, IL, Burham, IL, River Forest, IL, and Lincolnwood, IL)

According to the list, the cable system in Oak Park, IL raised basic rates from $9.95 to $14.95 in 1987. This system, however, added SportsVision, previously an $11.50 premium network, to the basic tier effective January 1, 1987. Moreover, the system dropped the rate of its eight premium networks by 21.7%, from $11.50 to $9.00.

o River Forest, IL Duplicate: See Oak Park, IL

o Beaver, PA

According to the list, the cable system in Beaver, PA raised its basic rates from $8.00 to $8.92 in 1987. The system's basic service rates did not change at all in 1987. The rate increase from $8.00 to $8.92 occurred prior to deregulation.

o Lincolnwood, IL Duplicate: See Oak Park, IL

Senator **Metzenbaum**. Your time has run out. Your time has run out. I will come back to you with some questions. We gave you 3 minutes extra because I interrupted you. Let me ask you some questions.

Mr. **Mooney**. Certainly, sir.

Senator **Metzenbaum**. Let me tell you what my constituents are saying about the cable industry today. From Cleveland Heights:

> For the time being I intend to disconnect from my local monopoly, until there is either some competition introduced into the market, or effective regulation is granted to State and local governments. I find the whole thing appalling and would appreciate your review and indication of your willingness to seek some form of protection for the consumer.

Another individual from Norwalk, OH, wrote:

> So many of us are on a fixed income, and with so many rates of the telephone and cable television being raised so often, we are finding it hard to keep up with the raises. Those of us who live alone really need the telephone. Also, the television is the only recreation many have. There are many of us senior citizens who feel something should be done to curtail some of the rate raises and would appreciate anything you could do toward this end.

According to you, Mr. Mooney, the cost to consumers of deregulation has been a modest 6-percent rate increase. But my information is quite different. I have a list of 93 systems with rate increases of 50 percent or more in just the first year of deregulation.

Let me ask you, what can possibly justify a rate increase of 458 percent, like the one in Denver, or a 220-percent increase, like that in Russell, OH?

Mr. **Mooney**. I would like to have an opportunity to comment individually on all 90-some systems you have on your list, Senator. I think in most instances, the facts were somewhat more complicated.

In Denver, for example, most people now—as a result of tier consolidation—pay less on their total monthly bill than they did prior to what has been described as "rate increases." What has gone on in many of these places is that different tiers of service have been consolidated into one to make it easier for consumers to understand what they are going to get.

And very frankly, in some places cable service, threshold service, was being sold for an unreasonably low rate, such as $2 or $3 or $4. And you know, you really cannot do it for that amount of money. Some people, yes, I am sorry to say, have ended up having to pay more. And people, of course, do not like having to pay more.

But in most instances, in which I have heard anecdotal horror stories, upon looking into them, the facts tend to be a little bit more extensive than is often given in the horror story.

Senator **Metzenbaum**. It seems to me, Mr. Mooney, that the tremendously high increase in the price per connection, which has soared since deregulation, pretty much confirms the fact that there has been a very, very substantial increase. Deregulation occurred what, 1½ years ago?

Mr. **Mooney**. At the end of December, 1986.

Senator **Metzenbaum**. So we have all of 1987. About 1½ years, something like that. A little less than a 1½ years.

As I understand it, the sale price of a system per subscriber has gone up from $1,200 to over $2,000, and I gather prices are continuing to rise. That would seem to confirm the fact that the owners and the buyers recognize that the potential for increases has not yet arrived. I think that it is a problem that, as I said before, we in Congress are constantly urged not to intervene in the private sector.

When the private sector does not do the right thing, with respect to labor relations, then we intervene sometimes on the side of labor, with the Wagner Act, and then we come back with the Landrum-Griffin Act, and then the Taft-Hartley Act, and we do intervene.

We intervene in a number of other areas where the private sector does not self-police itself. I am very concerned that the kind of self-policing that is called for is not occurring. I was in the private business world. I understand the fact that if you can charge $17 why should you charge $16, if you can get the $17, or whatever the figures may be.

But I will tell you that you have those of us in Congress who, in retrospect, question now why we deregulated AT&T, broke it up, why we deregulated the trucking industry. And now we are sort of questioning why we deregulated the right of cities to regulate your rates.

The failure of the FCC to define effective competition adequately was just an absurdity on its face and an indication of a lack of public concern as I see it. I think it was a very strained definition.

I do not think time permits me to engage in a lengthy dialog with you, but since I do not think it is fair for me to have the last word, I give it to you, sir, briefly.

Mr. MOONEY. Thank you, sir.

It will not surprise you, Mr. Chairman, if I do not agree as to the correctness of the FCC's judgment on effective competition.

Senator METZENBAUM. I am not surprised.

Mr. MOONEY. But I would add, we tend not to be theological about these things. We do not like to stonewall the Congress and insist that everything we do is fine and that all is milk and roses in our business. I mean, that is never the case in anybody's business.

We have tried to be as flexible as we can in all of our relationships with all levels of government. The Cable Act itself was the product of a compromise between my organization and the National League of Cities and the U.S. Conference of Mayors.

I heard must carry alluded to earlier in this hearing. We have tried very hard to get together with the principal broadcast trade associations to put a new must carry rule back in, only to have it struck down again by the U.S. court of appeals. I am on record as saying that we are willing to go back and try again.

Similarly, we are sensitive to the expressions of concern by Members of Congress and other elected officials, as to what should be proper behavior in the marketplace. I should say, Senator, that we think we have a good story to tell. I would ask you to keep only one thing in mind. As we continue to go through this process of evaluating the current state of communications law, including that which applies to us, we think we are putting something good on the table.

We are expanding the ways in which this society uses the video medium, and in a net sense, making a positive contribution to the

American society late in this century. We are willing to work with you and your colleagues in any way that we can to try and do even a better job.

Senator METZENBAUM. I think there is a lag period, but after the lag period expires, I think some of us will revisit the issue if there are not some changes made. I am being as candid as I possibly can.

Mr. Collins, we are very happy to welcome you here today. In doing so, as a spokesperson for Home Box Office, let me express my appreciation to you for being with us because Viacom, which also owns programming, Showtime, did not see fit to show up. We consider that an uncalled for snub. We resent it.

We are happy that you are with us, sir, and we think when a committee of Congress wants somebody who has a public interest and uses the public airwaves, we think that they are obligated to show up for a hearing of this kind. Viacom's conduct strongly meets with the Chair's disapproval.

Happy to have you, sir.

## STATEMENT OF JOSEPH COLLINS

Mr. COLLINS. Thank you, Mr. Chairman.

I am pleased to be here today at the subcommittee's invitation to testify on the distribution policies that have made HBO available to virtually all American homes.

Today's satellite-connected, national distribution network is a far cry from the initial transmission of HBO in 1972 to fewer than 400 homes in one Pennsylvania community. In the early 1970's, we distributed HBO by microwave, an inherently limited distribution system. It was clear that HBO had to find a new, broader, and more efficient distribution system if it was to extent the reach of its service.

In 1975, we took the historic step of delivering television programming to cable systems by satellite. The commonplace availability of satellite programming today sometimes obscures the extraordinary risk associated with that decision. Nearly $30 million was invested in HBO before it began to break even in 1977.

Satellite distribution revolutionalized the television business. It created an economic underpinning that allowed us to pursue innovative, original programming focusing on important and controversial topics that are not addressed elsewhere. Originally films like Sakharov, Murrow, Mandela, and Dear America: Letters Home from Vietnam, are meeting the challenge of television to stimulate and inform, as well as entertain American consumers.

The future of American television is bright and HBO is leading the way. Our goal is to be in every home in America. We have historically sought wide distribution of our programming through a variety of competing distribution mechanisms.

HBO has used virtually every distribution technology that has been available since our inception in 1972. In many cases, we pioneered technological developments that were necessary to create new, competitive distribution systems.

Our efforts to extend distribution of our services has not always been positive. Some distribution alternatives have not succeeded in the marketplace and, in some cases, these business failures have caused HBO to limit distribution of its programming through a particular distribution methodology.

However, HBO is in an intensely competitive business. There are numerous ways to see a movie, VCR's, over-the-air broadcasting, movie theaters. We have to ensure that, at the very least, consumers have the option to see movies on HBO. That is why it will continue to be our policy to use distribution technologies that are economically viable, technically sound, and provide quality distribution of our programming to consumers.

Mr. Chairman, selling pay television is a complicated business that requires constant attention to the consumer's shifting notion of what constitutes good entertainment. American consumers are fiercely independent and, after 50 years of experience with television, quite sophisticated in their tastes.

It takes a unique blend of statistical analysis, consumer research, intuitive feel, and just plain luck to be a successful pay program. HBO has had a difficult and challenging task and we cannot afford to miss any opportunity to reach potential customers. That is why we have always sought broad distribution of our services.

This policy has worked well for HBO for the last 15 years. We have become the largest brand-name subscription business in the world and we have not done this by artificially limiting distribution of our services. We have done it by offering consumers quality services through a variety of distribution systems. That is our policy today and that will be our policy tomorrow.

[The prepared statement of Mr. Collins follows:]

# TESTIMONY OF

## Joseph Collins, President
## Home Box Office, Inc.

Good morning, Mr. Chairman and members of the Subcommittee. My name is Joseph Collins. I am President of Home Box Office, Inc., a subsidiary of Time Incorporated. HBO was the nation's first and today is its largest pay television company. Our satellite-delivered program services, HBO, Cinemax and Festival, serve over 21 million subscribers in all fifty states.

I am pleased to be here today at the Subcommittee's invitation to testify on the distribution policies that have made HBO available to virtually all American homes. Today's vast, satellite-connected, national distribution network is a far cry from the initial transmission of HBO in 1972 to fewer than 400 homes in one Pennsylvania cable system. In the early years of its existence, HBO distributed its programming to cable systems by microwave links and each link required separate FCC approval.

By 1975, HBO had grown to 195,000 subscribers, but it was clear that microwave distribution was inherently limited. If HBO was to extend the reach of its services, it had to develop a new, broader and more efficient delivery system.

The necessity to broaden its distribution led HBO to the historic step of delivering television programming to cable systems via satellite. The commonplace availability of satellite program services today sometimes obscures the extraordinary risk associated with that decision. Nearly $30 million was invested before HBO began to break even in 1977. Many people considered satellite television a pipe dream. Obviously they were wrong. HBO has been one of the truly significant technological achievements of American business over the past 15 years.

The decision to distribute HBO via satellite revolutionized the television business and made possible a wealth of program choices that were the stuff of dreams prior to 1975. Consumers, of course, have been the primary beneficiaries. HBO has given consumers the ability to choose the programming they want to watch. The monthly subscriber fee is in effect a vote, which the consumer casts every month for or against the programming HBO delivers.

HBO's extensive national distribution system created an economic underpinning that has allowed us to pursue innovative, original programming, focusing on important and controversial topics that are not addressed elsewhere. Films like Sakharov, Murrow, Mandela, and Dear America: Letters Home from Vietnam, are meeting the challenge of television to stimulate and inform, as well as entertain American consumers. The future of American television programming is bright and, as it has in the past, HBO is leading the way.

From a distribution standpoint, HBO's goal has always been to be in every home in America. Consistent with that goal, HBO has historically sought wide distribution of its programming through a variety of competing distribution mechanisms. In fact, HBO has used every distribution technology that has been available since its inception in 1972. (The one exception is subscription television -- STV. HBO was unsuccessful in obtaining the necessary copyright licenses from the motion picture studios to allow it to distribute movies by STV.) In many cases, we pioneered technological developments that were necessary to create new, competitive distribution sources. For example, HBO supported deregulation of small receive only "dishes" in 1977. That deregulation, coupled with HBO's decision in 1985 to scramble its services, resulted in distribution of satellite programming directly to home dish owners. In other cases, HBO has been a strong early supporter of new distribution technologies. In the 1970s, for example, HBO sought distribution of its services through MDS operations. HBO continues today to offer distribution of its product through new technologies. In the past few years, for example, HBO has become a substantial player in the video cassette business.

Our efforts to extend distribution of our services have not always brought about positive business results. Some distribution alternatives have not succeeded in the marketplace, as we will demonstrate below. In some cases, these business failures have caused HBO to limit distribution ot its programming through a particular distribution mechanism.

HBO is not an essential service. Although we think our program services are very good, they are simply not life-sustaining, like electricity or heat. Moreover, Congress, the FCC and the courts have recognized that consumers can get similar programming to HBO's from a host of sources, including other pay services, broadcast television, basic cable services, pay-per-view and video cassettes.

Nor is HBO an essential service for entities seeking to offer a package of program services to consumers. Again, there are alternative program services available to such entities. As a result, HBO has no obligation to make its services available to every distributor that seeks to acquire them. HBO has been selective in choosing its distributors in those instances where it believes that selectivity results in improved efficiency and increased brand awareness. Notwithstanding our clear right, to select, and to limit, our distributors, HBO has used virtually every available video distribution technology. It has always been in our interest to do so.

And, it will continue to be in our interest to do so for one simple reason -- we are in a fiercely competitive business. There are numerous ways to see a movie -- VCRs, over-the-air broadcasting and movie theatres. We have to ensure that, at the very least, consumers have the option to see movies on HBO. That is why it is and will continue to be our policy to use video distribution technologies that are economically viable, technically sound and provide quality distribution of our programming to consumers.

Mr. Chairman, HBO's record as a distributor of video programming, utilizing every distribution alternative available, is unmatched. Our distribution policies are fully consistent with the antitrust laws and the Communications Act. Below, in specific terms, I discuss the history and current status of each of the ways in which HBO has attempted to deliver its services to consumers.

1. Cable Television. Cable television is HBO's primary distribution source. We have approximately 7,000 cable affiliates which account for nearly 20 million subscriptions. As a member of this industry for over 16 years, I am in a position to know that cable is the superior video distribution technology available today. The cable industry offers an efficient nationwide distribution system which reaches the vast majority of homes in this country. Cable operators understand the complex and dynamic nature of the pay television business and have an extensive knowledge of HBO's program services. Cable is a solid business which offers HBO stable profitability and quality distribution of our services.

Recently, HBO offered its cable affiliates the opportunity to purchase wireline exclusivity. The offer was limited -- it did not apply against non-wireline technologies such as MDS or home dishes. In addition, the offer required affiliates to meet marketing and promotional requirements with respect to the HBO services. Program exclusivity is premised on the belief that in this highly competitive environment a quality of uniqueness is necessary to attract consumer patronage.

Although our affiliates have expressed interest in exclusivity generally, they did not sign up for this exclusivity proposal in sufficient numbers to justify continuation of the offer. Therefore, we have withdrawn our exclusivity proposal for further consideration.

2. Video Cassettes. Since 1984, HBO has been involved in the distribution and sale of video cassettes. Through HBO Video, Inc., the largest independent video cassette distributor, we currently distribute video cassettes to wholesale distributors who in turn sell the cassettes to video retail outlets across the country. Predominantly these video cassettes are feature films, including films that are carried on HBO's program services and some that are made for original exhibition on HBO.

3. Home Dishes. Since January 15, 1986, when HBO began full-time scrambling, we have offered home dish owners three alternative ways to receive our services: 1) directly from HBO through a toll free 800 telephone number; 2) through the local cable operator; and 3) from the dish retailer who can arrange an annual subscription for our services.

Every dish owner in America can receive HBO's services. There is no denial of access.

The prices for dish owners are very attractive. A dish owner who subscribes to HBO and Cinemax on an annual basis (as over 80 percent of our dish customers do) can receive the services for $7.48 per month. That price is three dollars per month less than the average national price paid by a cable subscriber for HBO.

HBO also offers dish owners the ability to create program packages, selecting from the following services: HBO, Cinemax, CNN, Headline News, USA Network, Christian Broadcast Network, WWOR (NY), WSBK (Boston), KTLA (Los Angeles). The prices for these packages are comparable to that paid by cable subscribers for a package of program services.

The response from dish owners has been quite favorable. HBO now has over 250,000 dish subscriptions to its HBO and Cinemax services. We have an additional 100,000 subscriptions to the other services that are part of our package offering. We are currently adding between 14,000 and 18,000 new dish subscriptions per month.

As you may know, Mr. Chairman, there are proposals to create a federal right for any financially qualified entity to distribute our services and to regulate our prices. HBO strongly opposes these proposals and sees no legal or public policy rationale for such an extensive and far-reaching regulatory scheme. The record demonstrates that TVRO owners are being treated fairly. We are committed to continuing that treatment.

4. Satellite Master Antenna Television Systems (SMATV). HBO has provided its services through SMATV operations to commercial properties, such as hotels, motels and residential apartment buildings, since the early 1980s. Some aspects of this business are thriving. For example, HBO has a large number of subscriptions from hotels and motels. That segment of the SMATV business is profitable and growing.

SMATV distribution to commercial residential buildings has not been so successful. HBO distributes its services through commercial residential SMATV operators in two ways: 1) we have entered into direct affiliations with several large volume, broadly distributed SMATV operators; and 2) we actively encourage our cable affiliates to subdistribute our services to SMATV operators in their areas.

The results from our direct affiliations have been disappointing. We have entered into four such arrangements. One of the four companies has gone bankrupt. Another is in the process of selling off its SMATV properties on a piecemeal basis. The performance of the remaining two companies has been far below expectations. One of these companies projected 1987 year end HBO subscribership of 35,000 -- actual subscribers were only 13,000. The other company projected 1987 year end HBO subscribership of 90,000 -- actual subscribers were only 20,000.

Approximately 550 SMATV properties have been authorized to sell HBO through our cable affiliates. These properties have generated over 41,000 subscriptions.

5. Multi-Point Distribution Service (MDS). HBO has been distributed via MDS since 1974. HBO was a pioneer in MDS and our involvement with the technology increased throughout the 1970s and early 1980s. By 1982, HBO had 32 MDS affiliates in 28 cities serving 372,000 subscribers.

Beginning in 1982, however, the MDS business encountered serious reversals for a variety of reasons, including rampant theft of service and the growth of cable television. The MDS signal was not secure and was easily intercepted by pirate MDS receivers. From 1982 through 1985, HBO spent over $400,000 prosecuting theft of service cases.

Notwithstanding HBO's efforts to support MDS, 14 MDS affiliates have declared bankruptcy or gone into receivership. We have been forced to write off more than $5.9 million in receivables from MDS affiliates, a rate of delinquency unheard of among our cable affiliates. By the middle of 1986, HBO had only 24 MDS affiliates in 16 cities serving 146,000 subscribers -- a decline in subscribership of over 61 percent in less than four years.

Theft of MDS services continues to be an enormous problem for HBO. HBO is distributed in an unscrambled form by MDS operators in seven large metropolitan areas. We believe that as many as one million households per month are now illegally intercepting unscrambled MDS transmissions.

As a result of our experience, and after careful review, HBO has decided not to expand distribution of its services by MDS into new areas. However, we are continuing to distribute our services through our existing MDS affiliates and to provide whatever support we can to make these businesses viable.

Recently, multi-channel MDS (MMDS) has been authorized by the FCC. Although MMDS is a very new and unproven distribution business, HBO has an agreement in principle with Microband, the largest MDS distributor, which has plans to include HBO in an MMDS service in three metropolitan areas -- New York, Washington, D.C., and Detroit. We believe MMDS faces certain inherent difficulties as a distribution technology; however, we are experimenting with Microband and we will assess any future distribution by MMDS after an appropriate period. Finally, some of our existing MDS operators are offering HBO in an MMDS package.

As this record demonstrates, HBO has always sought wide distribution of its services. There are circumstances, however, where it may be necessary to limit one's distribution. For example, if a particular distributor experiences poor economic performance or if a distribution technology encounters repeated business failures, a supplier might be forced to limit its exposure to such losses. Similarly, if a distributor or a distribution technology proves to be technically poor or inefficient, a supplier might make the business decision to limit distribution through that technology. Chronically poor relations with consumers could also form the basis of a decision to limit distribution by a particular distributor or distribution technology. Such problems could occur in the context of any technology, including cable television.

Ultimately, the key to HBO's success is its brand name and the ability to market that name as a unique, reliable and high-quality service of interest and value to consumers. That is why we zealously protect the integrity of our service, the distribution as well as the programming. The best way to do that is to ensure that our distributors are technically and economically fit and that they maintain a high standard of customer relations. The vast majority of our distributors meet these qualifications. However, it is a simple business fact that not all distributors can do so. In those instances where a distributor cannot, prudent business practice suggests that a supplier limit its distribution with that distributor.

Mr. Chairman, selling pay television is a complicated business that requires constant attention to the consumer's very ephemeral and shifting notion of what constitutes "good" entertainment. American consumers are fiercely independent and, after 50 years of experience with television, quite sophisticated in their tastes. It takes a unique blend of statistical analysis, consumer research, intuitive feel, and frankly, luck, to be a successful pay programmer.

Our task is all the more difficult because we have to make our sale every month. The consumer can cancel at any moment by simply not writing out a check. Moreover, as I have stated, there are a variety of ways for consumers to receive the movies and other programming we offer. We cannot afford to miss any opportunity to reach a potential customer. That is why HBO, from its inception, has always sought broad distribution for its services. We have used every video distribution technology that has been available. We continue today to use every distribution technology that is economically and technically sound and offers quality service to consumers.

Our distribution policies have worked well for HBO and for the American consumer. In just 15 years since we first began service, HBO has become the largest brand name subscription service in the world. We have not accomplished this Herculean feat by artificially limiting distribution of our services. We have done it by offering consumers quality services through a variety of distribution systems. That is our policy today and it will be our policy tomorrow.

Senator METZENBAUM. Thank you very much, Mr. Collins.

Mr. Collins, does HBO have a corporate policy against selling to wireless?

Mr. COLLINS. No, sir, we do not have a corporate policy against selling to wireless cable, which we refer to as MMDS, or multichannel MDS. We do business with——

Senator METZENBAUM. What is the difference in multi-channel—what do you call it?

Mr. COLLINS. Senator MDS stands for multipoint distribution service, and that technology has been around since the mid to early seventies. By adding several more channels to the technology, so rather than one channel or two channels, it is three or more channels, that is referred to as MMDS, or multiple channel multipoint distribution service.

Senator METZENBAUM. Is that wireless?

**Mr. Collins.** That is called, from a marketing standpoint, to people who sell that, wireless cable.

**Senator Metzenbaum.** But is it wireless?

**Mr. Collins.** It is a microwave service. It is distributed via a big broadcast microwave transmitter and microwave receive locations.

**Senator Metzenbaum.** But there are now wires? You do not have to wire for it?

**Mr. Collins.** No, sir, there are no wires. There is no cable, either.

**Senator Metzenbaum.** And you sell to MMDC, or whatever it is called?

**Mr. Collins.** We, for many years, have been an extensive distributor through MDS, and I might add that it can only be described as a disastrous business experience for us.

**Senator Metzenbaum.** As a what?

**Mr. Collins.** A disastrous business experience.

**Senator Metzenbaum.** Why are you willing to sell it to these companies that testified here today?

**Mr. Collins.** Well, sir, in the case of Microband Corp., which does business in New York City, we have been a customer of theirs in New York for many years. They have been the common carrier operator of the MDS system in New York.

We have been discussing with them an arrangement, we have an agreement in principle, whereby our signal will be distributed over MMDS. It has been a very difficult discussion because of our concerns primarily over security, where we are very afraid that we will have replication of what happened in the MDS business where our signal is widely available for nothing and stolen, and that has been very bad for our business.

**Senator Metzenbaum.** Mr. Theroux said he cannot buy HBO. Can he?

**Mr. Collins.** Well, sir, I believe Mr. Theroux has had several contacts with people in our organization and he is not currently a customer of ours in Cleveland. I think that in the case of MMDS, we have some places that we currently do business, like Milwaukee, and we are seeing how the business works and if we can be comfortable with the very real, we think, and large security questions. Up until that point, we would be very reluctant to authorize additional transmissions.

**Senator Metzenbaum.** Have you seen any instances of your signal being pirated with the wireless?

**Mr. Collins.** Well, in fact, right now in Washington, as we sit here, our signal, HBO, is transmitted via MDS on an unscrambled basis. If you were to go out and purchase a decoder which is not addressable, there is no protection on it, you could mount it on your house and get HBO and not pay for it.

As I drove to the airport in New York yesterday, and it always saddens me, I can drive through portions of Queens where all you see are a forest of antennas of people who are watching HBO and not paying us for it.

**Senator Metzenbaum.** Mr. Theroux says he scrambles. Under those circumstances, why would you have any difficulty selling to him?

Mr. **Collins**. Well, sir, we are concerned that when you broadcast your signal in any form, which MDS is a form of broadcasting, that if there is any breach in the security, it is very difficult to get it back. So we would want to have some experience before we felt secure with that technology.

As an example, 10 years ago we all thought that single-channel MDS, because it was transmitted at microwave frequencies, was quite secure. We found out, unfortunately, that that was not true.

Senator **Metzenbaum**. When do you think you will have an answer for the wireless industry as to whether you will or will not make the product available?

Mr. **Collins**. Well, sir, we have a major test of all this that is going to happen in New York. We have one going on right now in Milwaukee. I am sure we will be discussing with Microband what goes on in this market and in Detroit. And we hope those are successful. But at the same time, we are very wary of that.

Senator **Metzenbaum**. When do you think you will have an answer?

Mr. **Collins**. I would hate to try and set a date, Senator, as to exactly when. It would be when we are sure that our signal will be secure and that the business is going to have a true financial underpinning that will keep us from having financial difficulty with those distributors.

Senator **Metzenbaum**. I will say the same to you. Certainly, you cannot operate wireless or competitive medium without being able to obtain product. And if the wireless companies cannot obtain product, they have to go under. That is just the reality of fact. It would seem to me that this is an issue that is not going to take a long time to resolve. Either it is going to be resolved or I do believe Congress will direct its attention to this subject.

I believe it is truly an antitrust issue that concerns us. We believe in free competition and have difficulty in understanding how the wired cable homes are entitled to better service, more available product than the wireless.

So I would say to you, Mr. Collins, just as I said previously, our concerns are not going to stop at the conclusion of this hearing, but that we will wait to see what happens in the next several months. If nothing happens, my guess is there will be a legislative proposal made to deal with the subject. And I feel confident if there is, we would have the votes to pass it. But I would much prefer to see the industry work out its own problems.

Our next witness is Amos Hostetter, chairman and chief executive officer, Continental Cablevision, Boston, formerly from Ohio. Happy to have you with us, Mr. Hostetter.

## STATEMENT OF AMOS HOSTETTER

Mr. **Hostetter**. Mr. Chairman, pleasure to be here. It is a particular pleasure, as you note, because Continental Cablevision was founded in Ohio 25 years ago in the communities of Tiffin and Fostoria, which I know you know well.

Senator **Metzenbaum**. Very well.

Mr. **Hostetter**. In 1963 my partner and I moved to those towns to begin what was then basically a reception service for an area that got very poor off-air television. We were engaged in every aspect of the business at that point from installing, and I will even say disconnecting subscribers who failed to pay their bill, to sweeping the front steps.

In the 25 intervening years, we have worked hard at it and the company has grown and prospered. Today Continental Cablevision serves almost 300,000 families in Ohio and nearly 2 million nationwide. We are now the third largest company in the cable industry.

I would hasten to point out that being the third largest cable operator is not like being ABC, CBS, or NBC. Being No. 3 in our industry means that we serve 4.4 percent of the cable homes, or 2.2 percent of the national TV homes. Our systems capacity ranges from 35 to 60 channels, and with the exception of local origination programming, we do not control a single programming service that we carry.

Compare our position with ABC, the third largest broadcast network which has an average audience share of 19 percent of the TV households and which owns outright stations serving 24.4 percent of the American households. The top three movie studios, Paramount, Disney, and Warner Brothers together have approximately 46 percent market share of the domestic box office revenues. The top eight studios have 87 percent.

In comparison, the top three cable companies, TCI, ATC, and ourselves serve 32 percent of the cable households, which is 16 percent only of national TV homes. The top eight MSO's serve only 23 percent of the TV households. It is a very different industry in its structure.

The entire cable industry from TCI, the largest, to mom-and-pops in Ohio serving several hundred homes has annual revenue of approximately $11 billion. I would point out to you that two of the Bell regional operating companies alone have revenue of greater than $11 billion.

Senator **Metzenbaum**. Give me that figure again.

Mr. **Hostetter**. $11 billion is the total revenue of the cable television industry. NYNEX and Bell South both gross more than $11 billion as single companies.

Put another way, the Bell operating companies are 25 times the size of Continental Cablevision, of my company, the third largest——

Senator **Metzenbaum**. What is the basic capital investment in those three companies as compared to the total capital investment of the cable companies?

Mr. **Hostetter**. I would say approximately the same relationships hold. They have about the same revenue to asset investment basis as the cable industry does.

To put it another way, any of those seven are 20 times larger than we are. And in fact, any of them are eight times larger than the cable industry's largest company, TCI. So I think it is important to keep in perspective, while this is an industry that has grown and prospered, it is far from a giant by U.S. industry standards. No cable television company is among the Fortune 500.

I have submitted a prepared text, and there are a number of issues that I touch on. If I may, I would like to skip to ones that might interest you, and I would be happy to answer any questions you have. It is your agenda.

[The prepared statement of Mr. Hostetter follows:]

# Statement of
# Amos B. Hostetter, Jr.
# Chairman and Chief Executive Officer
# Continental Cablevision, Inc.

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to appear before you this morning. While I'm not expert in antitrust matters, I have spent most of my professional life in the cable television business and am happy to share with you my observations on some of the public policy issues which are of concern to your Subcommittee.

On a personal note, Mr. Chairman, it is a special pleasure for me to participate in your hearings, as Continental Cablevision is a Company which I started in Ohio 25 years ago and today provides cable service to some 275,000 Ohio households.

In 1963, my partner and I moved to the Towns of Tiffin and Fostoria in the northwest part of the state and built our first cable system there. From installing new subscribers to sweeping the front steps we were involved in every aspect of that fledgling operation. In those days cable television was essentially a service to enhance the reception of local broadcast stations. It was not until the advent of satellite technology and the development of special cable programming services in the mid-70's that our industry began to fulfill its real promise by providing consumers with a rich choice of programming services such as Cable News Network, ESPN, Arts and Entertainment, Nickledeon, Discovery, USA Network and C-SPAN.

With the additional choices cable now provides, half of the television households in the U.S. today subscribe to cable. And even though network affiliates and independent stations still command 66% of audience share in cable households, consumers now tune to cable services a third of the time.

The chief reason cable has achieved popular acceptance is because of the special programming services which the cable industry itself has developed. As recently as 1975, the year HBO went up on satellite, cable penetration nationally was only 13%. What has caused the number of cable subscribers to multiply four-fold since then has been the additional programming choices we offer consumers.

## Concentration of Ownership

From our modest start in Ohio, Continental Cablevision has grown to become the third largest company in the cable industry, serving approximately two million subscribers across the U.S. Outside of the mid-west, our largest operating region is New England where we serve 450,000 subscribers in Massachusetts and 100,000 in New Hampshire.

To be one of the three largest cable system operators in the U.S. is not like being ABC, CBS, or NBC. Being number three means we serve 4.4% of the cable households and 2.2% of the t.v. households in the U.S. Our systems' capacities range from 35 to 60 channels and with the exception of local origination, we do not control any of the programming services we carry. Compare our position with that of ABC, the third largest broadcast network which has an average audience share of 19% of t.v. households and which owns outright stations serving 24.4% of American households. Together, the three networks have an audience share of 64% of American t.v. households.

The top three movie studios, Paramount, Disney and Warner Brothers together have a 46% market share of domestic box office revenues. The top eight studios have an 87% share.

In comparison, the top three cable operators, TCI, ATC and Continental serve 32% of all cable households and 17% of all t.v. households in the U.S. The top eight MSO's serve 47% of all cable households and 23.5% of all t.v. households.

Looking at the entire cable industry, from TCI, the largest operator with more than 8 million subscribers, to the smallest mom and pop operator with fewer than 500, total industry revenues for 1987 were $11 billion, less than those of several of the seven Regional Bell Operating Companies. For example in 1987, NYNEX and Bell South each had revenues of over $12 billion. This was approximately 25 times our revenues and seven times those of TCI in 1987.

## Telco Cross-Ownership

To suggest, as some have, that telco entry would promote greater competition, is sheer nonsense. Rather, we would soon see a cable industry dominated by the Bell Operating Companies, subsidized by telephone rate payers. Our industry has had long and bitter experience with the phone company, leading the need for Congress to enact the Pole Attachment Act of 1979 to assure access to utility poles at fair and reasonable rates.

If Congress were to mandate that programming developed by the cable industry be made available to all other distribution technologies, it would simply pave the way to telephone domination of this industry.

Cable's uniqueness as a medium lies in the specialized programming services which those of us in the cable industry have nurtured and supported over the past 15 years. C-SPAN, which brings this proceeding to 33 million cable households, was created specially as a public affairs service by the cable industry. Nickelodeon, for children, has filled a programming void which only public television previously had recognized. Discovery has brought the wonders of science into millions of American living rooms. Likewise, Black Entertainment, Galavision and Arts & Entertainment have been created in response to minority tastes and needs.

## Vertical Integration

While several major companies such as Time, Inc. and Viacom are both program producers and cable system operators, the vast majority of cable operators are not programmers. In fact, most cable operators do not have any ownership interest in the programming services they carry. However, when Turner Broadcasting experienced financial difficulties, cable operators responded in order to keep Cable News Network alive and independent. And when other cable programmers including Discovery and C-SPAN have encountered financial difficulties, we have voluntarily agreed to programming fee increases. Why have we done this? Not to become programmers but to maintain our identity as the medium of choice.

From the operator's point of view, the better a particular service is, the better all of cable looks as a mix. Cable operators want to see innnovative services survive. For new services, like Turner Network Television, operator investments and guarantees of exclusivity may be the only way to get early commitments to carry the new network at all.

Operator investment in programming is therefore a natural outgrowth of these forces. But a responsible operator will not just carry those services in which he has a small investment interest. If a service is not bringing in customers and disconnects are high, he will not destroy his retail business in order to support a programming investment. Many businesses operate with a mix of their own labeled brands and independent brands. Grocery stores, drug stores, clothing stores all operate in this manner. Safeway, CVS and Macy's could not make it just on generic brands, and must carry products that compete with their own products. The same is true for cable.

## Exclusivity

Having developed our own special programming services, is it unreasonable to want to maintain exclusivity of our product? Exclusive distributor relationships are common in the marketplace. From the automotive industry to the appliance industry to the broadcast industry, exclusive distributor relationships are part of the fabric of American business. You don't see Ford dealers selling GM cars any more than you see every appliance dealer selling Whirlpool and Maytag washers. And you won't see the NBC peacock strutting her stuff on CBS this fall.

Suppliers want assurance of quality distribution and service and aggressive local promotion. Distributors want the knowledge that their promotional efforts are going to accrue to their own benefit.

By their marketing and promotion, for example, cable operators have created brand name identification for HBO. Indeed, many of our subscribers think cable t.v. is synonymous with HBO. In 1987 we paid HBO almost $1 million a week for the carriage of HBO and Cinemax. In addition, we spent millions of dollars in advertising and direct mail marketing to promote HBO's products. We are, I understand, HBO's most successful customer in selling HBO services to our cable subscribers. Having made this substantial investment of time and money in promoting HBO is it unreasonable to seek exclusive distribution rights for HBO products in the markets we serve?

What programmers need today is affiliates who will conduct very aggressive promotional campaigns to differentiate their product and expand their distribution base. This promotion is essential to a cable network. Each one wants the public to sort out its brand name form among all the other channels. To do so, they must be given product indentification by their distributor. Cable operators who do this deliver a valuable service to the program packager, and therefore should be their favored distributor.

## Must Carry

Finally, Mr. Chairman, I'd like to change focus and address myself to the issure of must-carry which I understand will be the subject of the third panel this morning.

In the wake of the 1986 Quincy decision striking down the FCC's original version of the must-carry rules, the National Cable Television Association joined with the NAB, INTV and the Television Operators Caucus in reaching an intra-industry compromise to guarantee cable carriage of qualified local broadcast stations.

Unfortunately, in creating a new set of must-carry rules, the FCC changed the terms the parties had agreed upon, setting the stage for yet a second Court of Appeals decision declaring the new rules unconstitutional.

In spite of the fact that there has not been any governmental must-carry requirement for almost two years, the vast majority of cable operators have voluntarily honored the terms of the intra-industry compromise.

While you will hear of isolated instances where a local signal has been dropped, let me suggest that such instances represent a small minority of cases. Like ourselves, most cable operators have not dropped any local stations whose carriage was guaranteed under the intra-industry compromise. But even where signals have been dropped, there may be legitimate reason why, so it's important to hear from both sides to any signal carriage dispute.

Senator Hollings and Inouye, and Congressmen Dingell and Markey recently asked the FCC to gather data on the number of local broadcast signals dropped by cable systems. Most in the cable industry would join in supporting this initiative.

Clearly, in order to pass constitutional muster, any new set of must-carry rules will have to show a substantial governmental interest in protecting local broadcast stations. In this regard, I would urge you to ask the FCC one additional and key question: In those instances where local broadcast stations have been dropped, how many hours per week of local programming does the station produce? For if the deleted station does nothing more than carry satellite delivered programming, there is no reason such station should be afforded preferred status over CNN, BET or any other cable satellite service. Therefore, if the FCC's report is to provide proper justification for a new set of must-carry rules, it must look beyond the number of stations dropped to the amount of local programming they carry. Only then will the FCC have the necessary evidentiary foundation.

Mr. Chairman, since others appearing before you will discuss must-carry at greater length, let me conclude my remarks here. I'd be happy to answer any questions the Subcommittee may have.

Senator METZENBAUM. Let me ask you, Mr. Hostetter—your entire statement will be included in the record as will the entire statement of each of the witnesses today.

How important is the availability of HBO to the success of a cable system, or Showtime?

Mr. HOSTETTER. The availability of unique product is what has built the cable industry. The product we are selling is a smorgasbord of channels. And the fact that we have things from Black Entertainment Television to first run motion pictures, whether it be by HBO or by Showtime, it is the mix that we market and it is the uniqueness of that mix.

Senator METZENBAUM. You stated recently that following the acquisition of American Cablesystems, that it is inevitable that the cable TV industry will become more concentrated. What is the reasoning behind that prediction?

Mr. HOSTETTER. Because as yet, even the largest of these companies are not large by American industrial standards. And the trend towards concentration as a result of efficiency of operation, regional clustering of systems, additional revenue sources are going to come from more concentrated blocks of systems. The fact that Bascomb would have a different CATV company from Fostoria or from Tiffin or from Finley is just illogical, and eventually those clusters are going to pull together for the efficiency of marketing the service.

Senator METZENBAUM. Am I correct that just as in TV stations, cable systems have a one-time major capital investment? I know that there are supplementals. But in the main, you lay down the wire and that is the major capital investment, and from that point on that there is not substantial additional capital investment required unless you are expanding or unless you are buying up another system. Is that true or false?

Mr. HOSTETTER. That is false. The revenue-to-investment relationship in broadcasting, revenues will run five or six times the invested capital. In cable almost the reverse is true. Our invested capital will be five or six times our gross revenue. And the pattern is that every new customer who is hooked up requires an installation from the house, some internal wiring in the house, a converter box. We have $150 to $200 just per pop with each new installation.

We then have rolling stock to replace. We have to maintain and update the plant. The plant we built in Tiffin and Fostoria, OH, 25 years ago has been totally rebuilt twice since that day.

Senator METZENBAUM. Why is that needed?

Mr. HOSTETTER. Because the capacity of the plant becomes obsolete.

Senator METZENBAUM. That is because you are expanding.

Mr. HOSTETTER. We are adding to the number of services that we are offering.

Senator METZENBAUM. Number of services offered or number of persons served?

Mr. HOSTETTER. Well, as the town grows, we will grow with it. But that original system was a 12-channel system. We now have either a 36- or a 40-channel system in both Tiffin and Fostoria. We had an intervening step where we had a 25-channel system.

Senator METZENBAUM. What is the normal number of outlets? In other words, 30, 25, 40?

Mr. HOSTETTER. Channels on a system?

Senator METZENBAUM. Yes, channels.

Mr. HOSTETTER. Thirty-six is probably the standard today. There are some, I mean, we have systems with over 80-channel capacity. But 36—I think throughout our systems in Ohio we have a 36- to 40-channel standard.

Senator METZENBAUM. Explain this to me because I am not too hep as to what happens with these VCR's, et cetera. My recollection is that the VCR that we have does not have 36 different buttons on it. It has maybe 18 or so. How is that handled?

Mr. HOSTETTER. If you have a VCR, in addition to giving you a converter to operate your set, we will probably have to give you a converter to operate your VCR. So that you will not use the tuner on the VCR, you will use it on our converter.

And by way of remaking a point, instead of you being a household that would cost $150 to $200 to install, we have got to double that because you want to also serve your VCR.

If I may, Senator, picking up on a question to Mr. Mooney about rates. I would just like to make one point on that. Any year-to-year comparison is really tough. You do not know what the date of the last rate increase is.

I sat here and did a back of the envelope calculation. In 1965, when we started in Tiffin and Fostoria, our rates were $5.95 a month and we offered a 12-channel service. Today our rates there are approximately $14 and we offer a 36-channel service. CPI, which is a series that started in 1967, so it was a couple of years after we started, basis 1967 of 100 is currently 340. So if we had simply kept our rates up with the CPI, our $5.95 rate would now be $20.23. It is not. It is $14 and we have tripled the number of channels we are offering.

So I think there is an element of demagoguery in—not, please be sure, not suggesting by the chair or the committee, but by those who criticize cable's rate pattern. We have been incredibly restrained. And I would point out for Mr. Finneran's benefit, the record of State rate regulation was that in those States that regulated rates, rates were higher than in those States that did not regulate rates.

Senator METZENBAUM. Could you describe for us the trend of Continental's prices since cable was deregulated on January 1, 1987? In other words, what has been the percentage increase in your company's prices since that time?

Mr. HOSTETTER. I would be happy to. Our average basic rate in the State of Ohio on the last day of 1986 was $13.51. Our average rate on the last day of 1987 was $14.90, a 10.3-percent increase. Now our typical subscriber also buys a pay unit so that his bill was the $13 plus $9 for pay, approximately $22. We slightly lowered our pay rates from $9.72 to $9.70.

So the average Ohio customer's bill increased almost exactly 5 percent in the year 1987, in the year from the date of deregulation to a year later. That is only slightly above the CPI change for that year, and I think is a much more typical pattern both of us nationally and of the cable industry nationally than some of the specific examples that have been cited.

Senator **Metzenbaum**. I have some additional questions. We may submit them to you in writing, Mr. Hostetter. We are very happy to have you with us today.

Mr. **Hostetter**. I would be happy to respond, and I thank you for the opportunity.

Senator **Metzenbaum**. Our next witness is Mr. Robert Thomson, vice president of government affairs, TCI, Denver, CO.

## STATEMENT OF ROBERT N. THOMSON

Mr. **Thomson**. Good to see you again, Mr. Chairman.

Senator **Metzenbaum**. Good to see you, sir.

Mr. **Thomson**. Since I am batting cleanup, I am not going to summarize my statement in any detail. But I would like to focus on one or two of the issues that the other panelists have yet to touch on.

I would like to commend its reading, particular with respect to its description of the competitive environment which we think we operate in. In that competitive environment, broadcasting stations are clearly the dominant competitors.

With respect to our pay services—and I am sure Mr. Collins would agree with this—the VCR industry is a substantial competitor. As you may know, there are more television households that have VCR's now than those that have cable. In addition, in the VCR industry they have an earlier exhibition window than do our pay services; 3 to 6 months after a theatrical appearance a title will appear in a VCR store, as opposed to an average of 12 months for our premium services.

I would like to spend a little bit of time on the competitive impact of the home satellite dish industry. There are essentially four issues, Mr. Chairman, that have been discussed; the growth of the industry, access to programming, the prices that are available to customers in the home satellite dish industry, and the distributors that are allowed to distribute the product.

You have already received information on growth. The growth in the industry, as a matter of fact, has been quite phenomenal. There are a lot of dish owners out there.

As far as access to programming, they get all cable programming and more. It is true that some of the services are scrambled. But now that the scrambling technology is widely available, and there has been a settlement on a standard, access we do not think is going to be a long term problem unless the security of the encryption system is breached. If that happens, then access will once again be a problem.

As far as the prices, as you noted, my statement does say and our price list for TCI programming does indicate that home satellite dish owners can receive a basic package of programming which is very, very similar to that which our cable subscribers receive, for much less money; approximately two-thirds the cost.

TCI is not unique in that pricing practice. That is common to other cable companies and other distributors. It is the retail prices here that are important. It is the consumer, we would suggest, that we should be concerned about. And the retail prices to consumers are less.

In addition to that, when we talk about distributors, there are at least—I would suggest that there are now 20 distributors available that are active now in the home satellite dish marketplace. Only a very few of those are connected with cable.

As a matter of fact, cable is getting its lunch eaten in this particular marketplace. Only 5 percent of home satellite dish programming is sold by cable operators; 50 percent is sold by equipment—that is satellite equipment—wholesalers and distributors. The dish dealers themselves sell 20 percent or 25 percent. And Mr. Collins and Showtime and the others sell the rest directly. We do not monopolize this home satellite dish industry programming business by any stretch of the imagination.

As far as our business practices and policies and how we have responded to what we consider to be a very, very competitive market, I suggest to you that one of the first weapons we have used to compete is our pricing policy. We think we have low prices, some of the lowest in our industry. Last year we increased prices 6 percent after deregulation kicked in. This year we increased 5 percent, approximately at the rate of inflation.

I am going to stop now. You may have other questions for me, and I will let you set the agenda from here on.

[The prepared statement of Mr. Thomson follows:]

## Statement of Robert Thomson

Vice President

Tele-Communications, Inc.

Mr. Chairman and Members of the Subcommittee, my name is Robert Thomson, Vice President of Tele-Communications, Inc. ("TCI") in Denver, Colorado. TCI is an operator of cable systems throughout the United States.

Thank you for the opportunity to testify this morning and to give our views on a number of issues that now affect our industry. When an industry grows as rapidly as the cable industry has in the past few years and is so highly visible, we can understand why you, Mr. Chairman, and other Members of your Subcommittee would want to keep yourselves current on developments. Consequently, TCI is pleased to participate in this process.

We believe your study will reveal an industry that is entrepreneurial and competitive in the extreme and whose investments and creative efforts have yielded substantial benefits for the television viewing public.

In my statement today, I first would like to focus on the competitive environment in which the cable industry operates. Since this environment shapes the business decisions of cable operators and programmers, it is key to understanding how and why the industry works. Against that backdrop, I will discuss some of the business practices and policies of TCI, which represent our attempt to succeed in this competitive environment. Finally, I will briefly discuss some of the specific issues that are likely to be raised in your hearing today.

## A. COMPETITIVE OVERVIEW.

The cable industry is in the business of providing televised entertainment, news, sports, and information programming to homes and commercial establishments. In so doing, it competes with numerous other alternatives for consumers' leisure time and dollars.

Cable obviously faces the most direct competition from other video programming alternatives. First and foremost among these video alternatives are over-the-air television stations -- both local network affiliates and independent broadcast stations. In virtually all of our franchise areas, potential cable viewers can receive three or more broadcast stations. Although cable programming over the years has made dramatic inroads in increasing the number of cable subscribers, broadcast stations continue to account for the overwhelming share of viewing audiences. In spite of our offering of 30 or more channels of cable service, our subscribers spend 53 percent of their viewing hours watching the three broadcast networks and 16 percent watching local independent or public broadcasting stations.

The cable industry has grown in recent years, but the broadcast industry remains strong and healthy, judging from market activity. Notwithstanding changes in the tax laws and the stock market correction, 1987 was a record $7.5 billion year in station sales. Television sales in 1987 on a per station basis averaged approximately $28 million, an increase from $21 million in 1986 and very close to the 1985 zenith of $33 million. There is every indication that station values will continue to appreciate.

Ironically, some measure of this current health must be attributed to the cable industry, which under regulatory requirements, such as the "must-carry" rule, had to provide certain local over-the-air broadcast signals to cable viewers. Under the current "must-carry" rule, cable systems are required to facilitate over-the-air television viewing. Cable systems must install A-B switches for new subscribers which enable them to switch off cable and to receive broadcast signals directly. We are also required to educate our subscribers in the use of the switch and to inform them of over-the-air television alternatives to cable services.

In the process, TCI and other cable companies have made UHF independent stations much more powerful competitors than they otherwise might have been by extending their reach far beyond the geographic area in which the broadcast signals could be received by antenna. As a result of expanded viewership, these stations also benefit from increased advertising revenues, which enable them to be significantly stronger competitors to cable within their off-air service areas.

Cable's premium or "pay" movie services (only a decade ago the unique feature that propelled cable growth) are particularly affected by competition from the video cassette industry. Today, more American homes have VCR's than have cable. Prerecorded videocasette movies are widely available for rental prices as low as $ .99, even for movies not available on cable.

The VCR industry has a number of other competitive advantages over cable. In competing for viewing audiences, the VCR industry usually has an earlier distribution window for recent Hollywood movies. For example, the window for VCR rentals is as early as 3-6 months after theatrical release, but cable programming services must wait up to 12 months to exhibit the same product. Modern video superstores carry at least 7500 titles. This compares to a movie channel on cable which generally shows between 50 and 100 movies a month. Video tapes can be watched at the viewers' leisure, but cable movies are only available when scheduled. Finally, the VCR industry has the option to capitalize on whatever marketplace there is for movies unsuitable for over-the-air or cable transmission.

Another rapidly growing alternative to cable is the home satellite dish ("HSD") industry. The HSD industry is today competing with cable by distributing the very same programming that cable itself has developed over the years with investments of hundreds of millions of dollars.

Since HBO became the first programmer to scramble its signal in January, 1986 -- in a very real sense creating today's industry -- a standard scrambling technology has emerged, and despite early shortages, descrambling equipment is today widely available at prices that continue to decrease over time. The HSD industry has grown dramatically since this time; today, there are almost 2 million home satellite dish owners in the United States.

Recognizing the growing importance of the HSD industry, TCI has been a leader in efforts to market satellite programming to these viewers. Although TCI and other cable companies have the rights to sell cable programming to HSD owners in their franchise areas and adjacent counties, only a small percentage of dish owners actually buy their programming from cable operators. Recent market research we have done indicates that at least 20 companies are marketing cable programming to HSD owners nationwide, with 50 percent of the programming sold by HSD equipment wholesalers and manufacturers, 25 percent sold by equipment retailers, 20 percent sold directly by the programmers themselves and only 5 percent of HSD programming sold by cable operators.

Not surprisingly, given this range of purchasing options, HSD owners currently receive cable programming at retail prices far below that which cable subscribers pay. For example, HSD owners who purchase programming from TCI pay $10.50 a month to receive virtually every basic service. TCI's cable subscribers pay around $15.00 a month on the average for similar programming. An HSD owner can buy basic programming services plus HBO or Cinemax from TCI for $16.00. A comparable package costs cable subscribers around $23.00.

Another growing source of competition for cable operators is from multi-point, multi-channel, distribution systems ("MMDS") and satellite master antenna television ("SMATV") services, which offer additional distribution methods for satellite programming. Other distribution technologies, such as direct broadcast satellites, are likely to be available in the near future.

Telephone companies also compete with cable. Notwithstanding public perceptions, current law allows all telephone companies except for AT&T or the Bell operating companies to provide cable service anywhere outside their telephone service areas or, with an FCC exemption, even inside their service areas. In fact, there is a built-in exemption for phone companies to serve any uncabled rural areas within their service areas. Electric utilities are becoming increasingly interested in cable; for example, Florida Power and Light is actively overbuilding existing cable companies.

This brings us to another source of competition for cable operators -- other cable operators. Cable television franchises are typically non-exclusive. Overbuilding, where two cable systems compete head-to-head to attract viewers, has become a fact of life in our industry.

## B. TCI'S RESPONSE TO COMPETITIVE REALITIES.

TCI's business policies and practices are based on our realistic view of this competitive environment and of the cable product we sell. Cable programming is important to many consumers, but not at any cost. In economic terms, the demand curve for our product is highly elastic, since at certain price levels many viewers will turn instead to the range of alternatives described above.

Cable operators are not utilities with guaranteed rates of return on investment for providing, on an exclusive basis, an essential lifeline service. No cable company is guaranteed any return on its investment. Moreover, cable service is not an absolute necessity to anyone. Even in those areas where cable services are available, half of all households choose not to subscribe. Obviously, to sell our service we must convince people that we offer value equal to the the cost of our service.

TCI's financial performance depends on convincing the potential viewers who live in our franchise areas to exercise the option that each has to subscribe to cable. In recent years, TCI has taken a variety of steps to achieve this goal and has seen some measure of success in the rising level of cable penetration.

As a first step, TCI tries to keep its prices as low as possible, both in absolute terms and also in relation to our competitors. Currently our systemwide average rate for basic service is less than $15.00 a month. Almost all TCI systems that increased prices at the beginning of this year did so only at the rate of inflation. TCI would obviously like to be able to recover increased costs through price increases whenever possible. But the reality is that competition and local economic factors, not TCI's corporate policies, will have the determinative influence on future pricing decisions.

It is relevant to note that TCI's revenues per subscriber are lower than most other cable companies. In a study released late last year, our company ranked 19th out of the top 20 multiple systems operators ("MSO's") on a revenue per subscriber basis and 36th out of 53 cable companies measured. Whatever economies of size we enjoy, we pass on the savings to our subscribers. This is good business and good for consumers.

Of course, the cost of cable services to subscribers includes more than just the basic rate, and TCI also seeks to control these other components as well. For example, it is one of the few companies that does not collect a monthly fee for extra cable hook-ups. Cable companies that do levy such charges normally collect $3.00 to $6.00 a month from a subscriber for each additional television set hooked up in a residence, in addition to their regular charges. In addition, every TCI cable subscriber receives a monthly cable magazine (Cablevision) without any additional charge.

Like other cable companies, TCI has as one of its top corporate objectives improvements in the service and the programming we offer our subscribers. We believe that our business will be more competitive -- and more successful -- if we continue to improve the quality of the product we sell. With respect to service improvements, TCI generally uses internally generated cash flow. These funds are used primarily for increasing the channels and picture quality on our systems, extending cable to underserved areas, improving telephone and other administrative systems, investing in technological research and development, and training of customer service representatives and other system personnel.

Implementing this program involves significant financial costs. It is important to recognize in this context that the cable industry is still making capital investments to extend our cable to those who want it. Although it is possible now to foresee a day when all subscribers who can economically be served by cable are served, TCI and other cable companies are still spending enormous amounts of money on new-builds, line extensions, upgrades and rebuilds. For example, TCI will spend $240 million in 1988 alone for those purposes, including cost-intensive inner-city construction in major metropolitan areas like Chicago and Washington, D.C. TCI will build and improve enough miles of cable this year to stretch halfway around the world.

As we complete our program of system builds, more and more resources will become available to improve other aspects of our operations, such as telephone service and training of customer service representatives and installers. Since we have no guaranteed rates of return like a utility offering telephone or electric service, all these investments come at the expense of bottom-line, near-term profits. None of our cash flow goes to shareholders; TCI has never declared a dividend.

An equally important part of TCI's competitive strategy is to expand the range and quality of programming available to cable subscribers and to do so in way that creates an attractive body of "cable-unique" programming that will draw viewers to cable systems as opposed to other available alternatives. TCI has no controlling interest in any programmer. Our company does not manage any programming entity, nor does TCI, as a corporate objective, seek to become a programmer. However, we are committed to the concept that, given the number of video distribution technologies described above, the best way for cable to distinguish itself in the mind of the viewing public is to develop new and attractive programming options.

TCI has "put its money where its mouth is" by making several types of programming investments in recent years. One of the earliest examples of innovative programming pioneered by cable is C-SPAN I and C-SPAN II, which is funded primarily by cable companies. TCI is proud to have been one of C-SPAN's founders. As you know, these services televise proceedings of the House of Representatives and this body and other governmental and public interest proceedings in a level of depth never contemplated by the commercial television networks.

A more recent example of cable industry involvement to create new programming services is the bridge financing we and other companies are providing to the Vision Interfaith Satellite Network (the VISN Channel), which will launch this summer. VISN has been organized by mainline Protestant, Roman Catholic, Orthodox and Jewish groups to allow each group to reach cable subscribers with religious and values-based programming more efficiently, without on-air solicitations or criticisms of other religious views.

Second, TCI has made certain minority investments in a number of programming services which reach certain categories of subscribers who have been generally underserved by broadcast television in the past. These include our non-controlling investments in the Black Entertainment Television Channel, The Discovery Channel, which features quality nature, scientific and technology programming, and American Movie Classics, which features movies with substantial artistic merit.

Third, TCI and other cable companies have made timely minority investments in high quality programmers that are exceptionally popular among cable subscribers, but are threatened by adverse business circumstances. Last year, a consortium of cable companies made a substantial investment in the Turner Broadcasting Company ("TBS") to help that company survive. Ted Turner and TBS have made substantial contributions to the cable industry through programming services such as CNN and CNN-Headline News. Thanks to the cable operators' investment, TBS will continue to offer new services such as TNT -- Turner Network Television -- which will make its debut this fall.

In making this investment, all of us were concerned that the programming brilliance of Ted Turner and his associates might disappear from cable. Fortunately, it now appears this will not happen.

Fourth, cable companies have begun to explore investments in which particularly creative individuals might develop programming for the existing cable networks. TCI and other companies recently announced start-up funding for such a company called Think Entertainment headed by Shelly Duvall. The industry is also experimenting with various home shopping formats and testing the appeal of these services among our subscribers.

Before turning to some of the specific issues that might be raised before this Subcommittee, I would like to make one more point about programming. TCI has always considered itself to be a particular friend of public broadcasting. For many years, we spent hundreds of thousands of dollars to microwave PBS stations in the West to remote communities that had no local PBS outlet. At the same time, we are exploring ways that TCI can help local PBS stations get on their feet in states, like Montana, that previously had to rely on an imported PBS signal. We will continue to be supportive of public broadcasting in the public interest, but also in our own parallel interest, since the PBS stations reach an audience of potential cable subscribers.

## C. SPECIFIC ISSUES FACING THE CABLE INDUSTRY.

Finally, Mr. Chairman, I would like to address some of the specific issues that are likely to come up during the hearing today.

First, there are a number of issues involving the broadcast industry that routinely come up in forums of this sort, the most important of which is carriage of broadcasting stations by cable operators. TCI supported the FCC "must carry" signal carriage rule that was recently invalidated by the Court of Appeals here in Washington. You will recall the rule was loosely based on an inter-industry agreement. Our trade association filed briefs in support of the rule on appeal and TCI itself was on a brief opposing a stay of the Rule pending its appeal. Assuming appeals to the U.S. Supreme Court are unsuccessful, TCI would support a legislative solution to the "must carry" controversy as long as the legislation was again based on discussion among all affected industries and was tied to codification of cable's rights in other areas.

As indicated by the controversy concerning the "must-carry" rule, particularly difficult broadcasting issues have arisen concerning cable carriage and channel placement. Despite significant recent investments by cable operators to expand the channel capacity of existing systems, a large number of such systems are still limited to less than 36 channels. The resulting limitations mean that cable systems sometimes simply cannot carry all the programming that they might wish.

From the cable operator's perspective, these issues primarily involve marketing decisions--how can the limited channel capacity be used most effectively to attract and retain viewers to the cable system. This involves weighing the benefits of various programming options, as well as considering how various channel positions could be used as part of marketing plans (e.g., grouping various pay cable services on adjacent channels).

Not surprisingly, these considerations sometimes conflict with the interests of programming suppliers. A common charge made by broadcasters and others is that cable companies which have investments in programming disproportionately carry these programmers and do not carry others. That is not the case with TCI. Those programmers in which TCI has a minority investment are no more likely to be carried on TCI systems than any of the others. To us, subscriber appeal dictates carriage, not our investments.

Similar issues are raised by channel placement. For example, independent UHF stations have routinely asked federal authorities, in effect, to order their cable carriage on VHF cable Channels 2 through 13, assuming that these channels maximize their potential viewing audience. In many cases, mandated VHF carriage on cable would create a clear windfall for broadcasters who bought and paid for a less valuable UHF station.

Clearly, on-channel carriage, where a particular station will be found on the same channel both over-the-air and on cable, seems to be the best solution to most channel placement disputes. However, in cases where the station's assigned broadcast channel is higher than the channel capacity of the cable system, a different solution must be found.

A related problem occurs in major metropolitan areas, where there are several cable companies that may carry the same UHF station. If each cable company carries the station on a different channel, the UHF station owner may find it more difficult to market his station throughout a metropolitan area. Of course, this is a function of a fragmented cable industry, with many different operations in a metropolitan area. Cable programmers face exactly the same problem.

We have experienced such a situation in the San Francisco Bay area where TCI is one of many cable companies operating systems. Many of our systems there have 36 channels. KBHK, Channel 44, now cannot be carried on-channel on our systems and other systems with similar channel capacities. TCI has attempted to accommodate Channel 44 by carrying it on cable Channel 22 in as many of our systems as we can. The best solution in cases of this nature is for the cable companies and the broadcaster to work out a system of common channel placement through private discussion. It is my understanding such discussions are underway in the Bay area with Channel 44.

In addition to the broadcast issues discussed above, the Subcommittee is likely to hear discussions of the difficulties that alternative delivery systems allegedly have in obtaining rights to sell cable programming. Although these are issues that should be addressed by the programmers themselves, TCI does offer the following comments.

The statistics I have cited above should already indicate that in the HSD industry, there is a great deal of programming available to dish owners from many different sources at retail prices generally less than that which cable subscribers pay. As long as there is a relatively secure encryption system in place, this will continue to be the case, for programmers will have the incentive to create new programming secure in the knowledge that they will be able to achieve a return on their investment. On the other hand, if encryption security is breached, then TCI believes HSD programming availabiliity will suffer. In our view, no programmer will provide, nor can it be expected to provide, its product to a medium where that product is regularly and systematically stolen.

TCI strongly endorses the programmers' rights to prevent breach of their sales contracts and blatent theft of their products. We cannot ask our cable subscribers to pay for programming services that are available without any payment to their friends and neighbors.

## D. CONCLUSION.

This is a new industry, rapidly growing and rapidly changing. As in any such industry, what was gospel yesterday can become heresy tomorrow. To legislate or regulate in such a rapidly changing environment is to risk creating artificial rigidities that will work against consumer interests.

Instead, consumer interests are best served by allowing the market to work its magic -- creating incentives to identify and satisfy consumer needs and desires. Of course, individual producers and suppliers will not all prosper, but those who correctly perceive what the marketplace wants will do well.

In the interim, there will be numerous disputes and points of contention or stress, and each of the relevant players -- cable operators, programmers, the creative community, commercial television networks, independent broadcast stations, public television stations, SMATV, MMDS, etc. -- will have its own perspective, its own solution. For our part, TCI is always willing to listen to those with different perspectives, working toward solutions that all can live with. Hearings like this will help that process, and I will be glad to answer any questions you might have.

Senator METZENBAUM. Thank you, Mr. Thomson. You have heard the home satellite dish industry complain that some programming is available only through cable. According to the October 1986 Channels magazine, TCI actively intervened to try to prevent programmers from directly selling to home dish owners. Did not TCI then turn around and market its own package to dish owners?

Mr. THOMSON. I think the article is incorrect. As a matter of fact, today the programmers do market directly to home satellite dish owners. They sell more programming, approximately four times more programming than all of the cable operators do.

It is true that we do market a home satellite dish package to dish owners in our adjacent areas. But you must keep in mind that we and all other cable companies have been limited by market arrangements to only our franchise area and adjacent counties. We are not allowed to sell nationally like the other third-party packagers are, and that is a tremendous competitive disadvantage for cable in serving this marketplace.

Senator METZENBAUM. Where does that limit come from?

Mr. THOMSON. From the programmers.

Senator METZENBAUM. From the programmers. So that the programmers are restricting the competitive potential for your company?

Mr. THOMSON. You could put it that way. But on the other hand, there is a number of national distributors which the programmers have authorized in one way or another to do business. I am not saying that that is an unreasonable restriction. They have a difficult situation to deal with because they have a lot of people who want to distribute their programming, as you heard today.

Everybody can get access to movies from Hollywood. What they want though is access to the HBO brand name. That is the key. And I have all the sympathy in the world for the HBO's and the Showtime's of the world trying to make their way through this thicket.

Senator METZENBAUM. I am sure they appreciate your sympathy, but I think they are doing pretty well without the sympathy, are they not?

It is my understanding that Netlink offered a contract to the National Rural Telecommunications Cooperative in connection with programming packages that the cooperative was offering to home dish owners. Before the contract was completed, as I understand it, TCI bought a controlling interest in Netlink and the contract offer was withdrawn. True? False?

Mr. THOMSON. Absolutely true. And here is the circumstances. Netlink—you want me to respond in detail, I take it, because it is a detailed story. Netlink when they were first in business were not in any way associated with TCI. Their intention at that time was to uplink, without restriction, network affiliates and let any dish owner that lived anywhere order these network affiliate signals.

They came to TCI and requested financing and talked about a mutual business relationship. We decided that we would want—that we thought it would be a good idea to finance them for reasons of our own. The problem was that their method of business was under attack in Federal court here in New York State and also in Atlanta by the networks themselves because it represented an unlicensed distribution, even in areas where local affiliates showed network programming. Consequently, when TCI got involved, we insisted that the previous business plan upon which their contact to NRTC had been based, be scrapped.

Now we are in the process of actually negotiating with the networks for the right to use their signal and to distribute to "white area" dish owners. Until those contracts are negotiated, we are not at liberty to entertain the request by others to distribute the programming. As soon as those contracts appear in their final form, we will be happy to revisit that issue.

Senator METZENBAUM. When will that be?

Mr. THOMSON. That is hard to say. It is up to the networks, to some extent. We anticipate we will have more word on that in 3 or 4 weeks.

Senator METZENBAUM. TCI is rapidly developing an image as the monolithic king of the heap in this industry. As a matter of fact, I think you are a leader in the trend toward vertical integration. As I understand it, you hold an equity stake in a number of major programmers, including WTBS, CNN, Headline News, BET, Temple TV, the Fashion Channel, American Movie Classics, and Home Premiere.

Several of the programmers which TCI controls in whole or in part refuse to deal with cable competitors. True or false?

Mr. THOMSON. We are not ashamed of the fact that we have taken our subscribers money and used it to improve the quality and variety of programming. Using the term vertical integration to describe the minority investments that we have in programming is probably not exactly correct. We do not own any programmers. We have no controlling interest in any programming entity. We have no corporate objective to become a programmer. Others do that job much better than we do.

However, we have never had a subscriber complain to us about taking their money and using it to improve the quality and quantity of programming.

Senator METZENBAUM. That is really not the question, Mr. Thomson. You are not meeting the issue. The issue is, it is not a question of whether you are taking your subscriber's money. The subscriber has no control at all over what you do with your money. If you want to take your money and buy a jet plane, you want to take a trip to Bermuda, that is your problem.

The real question is vertical integration. Vertical integration is a concern of this committee, and I do not think you are addressing yourself to that question, and I appreciate if you would.

Mr. THOMSON. I am saying, Mr. Chairman, that we have really no control over any of these programs. We do not have a controlling interest over any programmer. We essentially make four types of——

Senator METZENBAUM. What percentage position do you have in CNN?

Mr. THOMSON. We have approximately 12 percent of all Turner, but we have a minority—all the cable companies together only have a minority interest in Turner. Turner would, of course, have disappeared from the airwaves but for the cable investment in Turner.

Senator METZENBAUM. I could go through each of them that I mentioned, and what is the range of ownership position you have in each?

Mr. THOMSON. As I said, it is always less than 50 percent. I would be happy to provide that for the record. I will give you some idea——

Senator METZENBAUM. You know as well as I do, you do not have to own 50 percent in order to have control. General Motors was controlled for years by one family that had an infinitesimally small percentage position. Generally speaking, most American corporations are controlled by individuals or groups that have far less than 50 percent.

Mr. THOMSON. That may well be the case in general corporate life, but I would say to you that we neither have control in fact nor control in votes with these programmers.

Senator METZENBAUM. All right. Thank you very much, Mr. Thomson. I want to thank the rest of the panel. I appreciate your being here with us today.

We will now proceed to our last panel, Gary Chapman, senior vice president, Freedom Newspapers, on behalf of the National Association of Broadcasters, from Riverside, RI; Milt Maltz, a friend of mine from Cleveland, Malrite Communications Group, on behalf of the Association of Independent Television Stations, from Cleveland, OH; Wendell Triplett, from WWAT–TV, Chillicothe, OH; and John Siegel, president of KBHK–TV, San Francisco, CA.

We are very happy to have you with us. Mr. Chapman, would you be good enough to proceed, please?

## STATEMENT OF A PANEL CONSISTING OF GARY CHAPMAN, SENIOR VICE PRESIDENT, FREEDOM NEWSPAPERS, ON BEHALF OF THE NATIONAL ASSOCIATION OF BROADCASTERS, RIVERSIDE, RI; MILTON MALTZ, MALRITE COMMUNICATIONS GROUP, ON BEHALF OF THE ASSOCIATION OF INDEPENDENT TELEVISION STATIONS, INC., CLEVELAND, OH; WENDELL TRIPLETT, WWAT-TV, CHILLICOTHE, OH; AND JOHN SIEGEL, PRESIDENT, KBHK-TV, SAN FRANCISCO, CA

Mr. CHAPMAN. Thank you, Mr. Chairman. First, I want to thank you for inviting me to testify today on the competitive issues of the cable television industry. My name is Gary Chapman, and I am senior vice president of broadcasting for Freedom Newspapers, which owns five VHF television stations in five different States.

I am also appearing on behalf of the National Association of Broadcasters, which represents 950 television stations, all the commercial networks, and over 5,000 radio stations. I presently serve on the NAB television board of directors. We welcome the subcommittee's interest in these important issues and commend you for holding these hearings.

To summarize what has happened in the local video marketplace, an essentially level playing field has been radically tipped in favor of cable. For purposes of copyright law, cable is treated mostly as a passive antenna device that simply retransmits signals. Within the context of the must-carry litigation, however, cable is treated as an active editor which can wield the sword and shield of the first amendment. So long as cable can exist under the best of both worlds treatment, it has the legal and regulatory upper hand.

Policymakers should be troubled by this situation, especially those with jurisdiction over competitive issues. These are the cards with which the local cable operators can play when he sits down with our television stations.

In our markets, cable penetration runs from a low of 50.8 percent in Beaumont/Port Arthur, TX, to a high of 61.5 percent in Albany/Schenectady and Troy. He can decide to carry our stations or not carry our stations. As a result, the cable system have their thumbs on the scales of competition within the local video market.

Through its carriage decision, the system directly can determine what its subscribers view, and indirectly can affect the quality of what nonsubscribers view. Thus, it affects the overall competitive status of all local television stations whether they appear on the system or not.

This subcommittee should question whether cable should be permitted to possess such power, much less exercise it. He can cherry-pick a portion of our programs. He will not have to bargain for or pay for their carriage rights, although he can seek payment from us for carriage. He can decide to carry our stations on our channel numbers or he can ship them up to the equivalent of Siberia.

He can bring the same network programming that is carried on our stations through the network affiliates licensed to larger cities relatively nearby our markets, such as the case of Providence/New Bedford. He can bring in distant signals or superstations which also may duplicate the programs which our stations have paid a great deal to acquire the exclusive rights.

Consider the experience of our Medford/Klamath Falls television stations. We have purchased the rights to broadcast "Cheers," "Family Ties," and the new version of "Star Trek" in syndicated form. Prior to 1980 when the FCC syndication exclusivity rule was in place, we would have been able to protect these exclusive rights by requiring local cable systems to delete these shows from any nonlocal signal that they were importing into our market.

The circumstances are far different today now that synd-ex rule is gone. Through cable's ability to import distant signals under the compulsory license, and our inability to protect our bargained for exclusivity, local cable systems are able to import stations from Portland, Oakland, Sacramento, each with these same three programs. And additionally, some systems carry superstation WGN which airs "Cheers."

He competes with us for local and national advertising dollars. He can make any and or all carriage decisions based on what makes him a better buy to the advertising community.

For example, one of our stations operates in Albany/Schenectady/Troy television market. In Albany, our station is carried on a system owned by ATC, whose parent is Time. Time also owns 100 percent of HBO, 100 percent of Cinemax, 100 percent of Festival, 11.5 percent of superstation WTBS, 11.5 percent of CNN, 11.5 percent of Headline News, 16 percent of Black Entertainment Television. And a similar situation also exists with Mr. Thomson's company in Schenectady where a similar situation exists.

Regulatory equilibrium between local television stations and cable must be restored. At least two elements are needed for this restoration; some degree of must-carry protection for local television stations, and the reestablishment of the syndicated exclusivity rules. Pending at the FCC——

Senator **Metzenbaum**. Please wind up, Mr. Chapman.

Mr. **Chapman** [continuing]. Is a proceeding which could result in the reimposition of the synd-ex rule. The NAB strongly supports this result. Also, the must-carry issue may be more problematic. The NAB and other broadcasting interests are pursuing legal remedies available to us following the December decision in the court of appeals.

The NAB believes that Congress also should consider legislation to implement some form of must-carry. We feel that that will properly craft——

Senator **Metzenbaum**. Mr. Chapman, I have to cut you off.

Mr. **Chapman**. Thank you, Mr. Chairman.

[The prepared statement of Mr. Chapman follows:]

National Association of
NAB
BROADCASTERS

# TESTIMONY OF
# GARY R. CHAPMAN
SENIOR VICE PRESIDENT, BROADCASTING
FREEDOM NEWSPAPERS, INC., RHODE ISLAND

BEFORE

THE SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS
OF THE SENATE JUDICIARY COMMITTEE

ON

COMPETITIVE ISSUES IN THE CABLE TELEVISION INDUSTRY

MARCH 17, 1988

Thank you for inviting me to testify today on competitive issues and the cable television industry. My name is Gary R. Chapman, and I am Senior Vice President, Broadcasting, for Freedom Newspapers, Inc., in Rhode Island. Freedom Newspapers owns 5 television stations in five different states.[1] From 1979 through 1984, I was General Manager of WLNE, Freedom's station in the Providence/New Bedford television market.

I also am appearing on behalf of the National Association of Broadcasters, which represents over 950 television stations, in addition to all of the major commercial networks and over 5000 radio stations. I presently serve on NAB's Television Board of Directors. We welcome the subcommittee's interest in these important issues and commend you for holding these hearings.

## Background

As you already have heard today, the status of the video marketplace in 1988 is dramatically different than it was just a few years ago. This is especially true regarding the relationship between local television stations and cable. My testimony will focus on one aspect of that particular segment of the video marketplace, how the loss of the must carry rule affects the ability of local television stations to serve the viewers in their communities.

Prior to 1980, cable and television broadcasters were on a relatively even footing. The Federal Communications Commission's must carry rule assured local television stations that they would be carried on the cable systems serving their markets. For cable, the compulsory license granted by the 1976 Copyright Act entitled cable systems to retransmit local television stations without negotiating for the rights to do so, and without any payment to those local stations. This compulsory license also entitled cable systems to carry distant signals without negotiating for these retransmission rights, at rates set by the government.

This statutory compulsory license reflected the FCC's existing regulatory structure. At that time, the FCC had other important regulations in place in addition to the must carry rule. These included restrictions on the numbers of distant signals cable systems could import into markets, and protections against the importation of programs for which local stations already had exclusive rights (the "syndicated exclusivity" rule).

To be sure, this system was not without its flaws for both broadcasters and cable, and it perhaps was not the structure that would be created in a perfect world. Whatever its flaws, however, the old system was far superior to the regulatory and legal conditions under which local television stations operate today.

By 1980, the FCC had eliminated the distant signal and syndicated exclusivity rules, but the must carry rule remained in place as an important counterweight to the compulsory license. As you know, however, in 1985 the Court of Appeals for the D.C. Circuit threw out the FCC's original must carry rules on First Amendment grounds, and the same Court invalidated the FCC's revised must carry rules in December, 1987, again on First Amendment grounds.[2]

In what are perhaps now cliched Washington terms, an essentially level playing field has been radically tipped in favor of cable. For purposes of copyright law, cable is treated mostly as a "passive" antenna device that simply retransmits signals. Within the context of the must carry litigation, however, cable is treated as an active "editor," which can wield the sword and shield of the First Amendment. So long as cable can exist under this "best of both worlds" treatment, it has the legal and regulatory upper hand. Policy makers should be troubled by this situation, especially those with jurisdiction over competitive issues.

To the casual observer, must carry and the related cable issues might appear to be of relatively minor importance to my company's television stations. All of our stations are network affiliates, all are on the more advantageous VHF channels. One might think that our stations are those most likely to be carried on local cable systems with or without must carry. Furthermore, if our stations are not carried, one might think they are the stations that viewers will most easily and willingly receive off-the-air. Unfortunately, the real world is not that simple. Carriage on cable, and cable's present ability to act as a gatekeeper over access to homes, is as important to our stations as it is to the UHF independent stations you will hear from today.

## Localism and the importance of cable carriage

Our nation's free, over-the-air television structure is erected on a foundation of local stations serving local communities. Rather than a system in which a greater number of regional stations could be established, Congress enacted a system through which the needs and interests of communities would be served by smaller numbers of local stations. Congress' goal with localism was to ensure that each community of appreciable size would have at least one station to address community needs and interests, and to permit multiple stations in communities wherever possible. This system is reflected throughout the Communications Act and FCC regulations, but finds its clearest expression in Section 307(b) of the Act.[3]

In return for their FCC licenses, television stations have statutory and regulatory obligations to their local communities. Stations are obligated to identify, and serve with responsive programming, the needs and interests of those communities.

This system can not function properly, of course, unless local television stations have access to the viewers they are licensed and required by the FCC to serve. An "open gate" between local stations and their viewers must be preserved, for stations simply cannot respond to viewers that they cannot reach.

Access to local audiences can be both enhanced by, and frustrated by, cable. As it originally developed, the cable industry was a means to facilitate reception of local over-the-air television stations. Indeed, cable first was called "community antenna television." Today, cable provides many additional kinds of programs, but retransmission of local television signals remains one of cable's most important attractions for subscribers.

Once a home is connected to cable, however, that home becomes extremely dependent upon that cable for reception of local television stations. Even though these signals theoretically are available over-the-air, when a local television station is not carried on the cable system, cable subscribers effectively lose their ability to watch it. The cable becomes a gate, over which the local system has control.

NAB and other groups have documented in FCC proceedings why the "A/B switch," a mechanism that ostensibly selects between cable and over-the-air reception, is in fact inadequate as a substitute for cable carriage of local stations. For many homes, this switch will not deliver adequate off-air reception, because the over-the-air signals are obstructed by tall buildings in urban areas, hilly terrain, or even foliage. Many viewers subscribe to cable in whole or in part to get better reception of local television signals.

Even where off-air reception of local signals is possible, nearly all viewers must use an outdoor antenna with the switch. In most cases, indoor antennas are inadequate. Furthermore, outdoor antennas usually require substantial additional equipment in conjunction with the A/B switch.

NAB's 1985 survey of cable subscribers revealed that hardly any cable subscribers had A/B switches. Only 1% of subscribers had an A/B switch and an outdoor antenna. Many subscribers no longer had access to an outdoor antenna, either because they never owned one, they were told by the cable system that they no longer needed one, or they (or their cable system) removed the antenna once they subscribed. In many communities, outdoor antennas are prohibited or restricted, or viewers live in multiunit buildings in which access to outdoor antennas is impossible or impractical. In addition, with increasing use of VCR's and other equipment that attaches to the television set, the installation and use of A/B switching devices has become exceptionally confusing and difficult.

In short, the overwhelming majority of cable subscribers would have to invest or reinvest in a costly and complex array of equipment to have access to local stations not carried by cable. Once the equipment was installed, cable subscribers would have to use it correctly each time they wanted to view stations not carried on cable, rather than merely tune passively to whatever programming was on the cable. Cable systems thus have effective gatekeeper control over the availability of local stations to viewers these stations are licensed to serve.

The current nationwide cable penetration rate, the percentage of homes that subscribe to cable, is 50.5% of all television households.[4] For our stations, local cable penetration rates range from a low of 50.8 percent in Beaumont/Port Arthur, Texas, to a high of 61.5% in Albany/Schenectady/Troy, New York.[5] That means that in every market we serve, more than half the homes are hooked up to cable. If we are not carried on those systems, we immediately lose access to more than half our potential audience, and we must find some other way to reach those viewers.

**Alternatives to cable do not exist**

Carriage of stations on cable systems might not be such a crucial matter for local television stations if carriage alternatives were available. Such alternatives, however, do not exist in most communities. Cable systems almost never compete head-to-head with other cable systems in their franchise areas, a situation described by the cable industry as an "overbuild." (It is noteworthy that the cable industry uses a vaguely pejorative-sounding term to describe head-to-head competition.)

Some argue that cable is a natural monopoly in the economic sense -- that it simply is uneconomic for two systems to operate in the same area. Whether cable is a natural monopoly is essentially irrelevant, because in many communities cable has a legal monopoly, which the local franchising authority may grant under the Cable Act of 1984.[6] As a result, competition among cable systems is extremely rare. Presently, there are perhaps as many as 36 franchised cable systems (out of a nationwide total of approximately 6500) that face competition from other franchised systems.

What about the other wire into the home -- provided by the telephone company? Some day telephone companies may provide video service to the home in competition with cable, but that day still is far away. Many technological and policy hurdles must be crossed before video service via telephone systems is practicable.

Therefore, a television station denied carriage on the local cable system has no competing system to which it may look for carriage within a community. Cable subscribers who are unhappy with the local television offerings on their system cannot threaten to take their business elsewhere. Nor can the local government exercise much, if any, influence over whether local television stations will be carried on the local cable system. The Cable Act severely limits the controls that local governments can exercise over the programming carried by the cable systems they franchise.[7]

### Cable's carriage decisions impact upon local competition

Thus, with the must carry rule gone, cable now has an important weapon at its disposal -- the discretion to carry or not to carry any or all local television stations, including the ability to require payment for carriage. It is important to realize, however, that a cable system's refusal to carry a particular station affects not only what the system's subscribers view, but it also indirectly affects what will be viewed by non-subscribers. Simply put, a television station's audience size directly translates into revenue -- larger audiences attract larger revenues, through the sale of advertising time. If a station is not carried on cable, and thereby loses a substantial portion of its audience, it will lose revenue. With less revenue, the station can not serve its community as well. The station will have less money to invest in equipment and programming. The attractiveness of its programming will lessen, as will its audience. Revenues will continue to decline, and the cycle will repeat.

Cable systems have their thumbs on the scales of competition within a local video market. Through its carriage decisions, a system directly can determine what its subscribers view. It indirectly can affect the quality of what non-subscribers view. Thus, it affects the overall competitive status of all local television stations, whether they appear on the system or not. This subcommittee should question whether cable should be permitted to possess such power, much less exercise it.

## Cable's discretion over channel-positioning can be used unfairly

The original must carry rule required, for the most part, "on channel" positioning. Now that the must carry rule is gone, cable also has virtually total discretion over where local television stations will be positioned on their systems. Television stations' identities are created, in large part, around their channel numbers. While the cable channel on which a television station will be carried may not be as crucial to the station as carriage itself, the system's discretion over channel positioning can lead to competitive abuses.

Cable systems can favor some stations by transmitting them on-channel, while other stations can be shifted onto far less favorable channels, where subscribers are less likely to view them. By repositioning stations to less favorable channel positions and substituting cable networks on the more desirable channels, cable operators have the power to manipulate dramatically subscribers' viewing patterns. A.C. Neilsen studies are reported to show that viewership of cable networks can increase an average of 32 percent when cable networks are placed on cable channels 1 through 16. This discretion over channel positioning is especially relevant in the context of competition for advertising dollars, discussed below.

## The compulsory license

Cable has many more legal and regulatory advantages over local television stations than just this crucial power over carriage and channel positioning. The compulsory license granted to cable by the Copyright Act of 1976 also provides huge competitive benefits for cable. As noted above, the compulsory license remains in place, even though the FCC regulations that were part of the balance struck by the 1976 Act have all but disappeared.

The compulsory license permits cable systems to retransmit the programming of television stations without negotiating for right to do so, and without the consent of either the station or the program owner. Cable systems can and do use this license to retransmit the signals of local stations, to import "superstations" (such as WTBS in Atlanta, WOR in New Jersey, or WGN in Chicago), and to import other distant independent or network-affiliated stations. Under this compulsory license, cable systems do not pay for the right to retransmit local programming, and pay only government-set rates for distant signals through the Copyright Royalty Tribunal, not marketplace rates.

Under today's circumstances, our stations have no right to insist upon carriage on local cable systems. These cable systems, however, can use the compulsory license to retransmit the programs of our stations, without our consent, or without payment. A cable system can exercise its rights under the license to carry only a portion of our stations' programming -- we cannot insist that if any of our programming is carried, then all of it must be carried. Under the compulsory license, a cable system would be permitted to "cherry pick" only those programs it wishes to carry, such as our highly-rated local news programs, and ignore the rest of our schedules.

Furthermore, these cable systems can use the compulsory license to import superstations and other distant network and independent stations. Again, under the license, this is done without the consent of, or negotiations with, these stations, at prices that are far below what might be negotiated under normal marketplace conditions.

These rules mean that in the cable homes in our markets, we compete not only with other local stations and the multiple channels of cable programming carried on those systems, but also with a host of television programming imported from other markets. In many cases, the programs carried on the imported stations compete directly with programs that we run on our own stations, both network and syndicated programming.

While these imported stations enable the cable systems to cheaply provide additional viewing options for cable subscribers, they also siphon away local audiences. Again, unlike cable, our stations' licenses carry with them the obligation to serve the needs and interests of our local viewers. The revenue we generate to do so comes only from the size of the local audiences we can attract. Our stations deserve a fair chance to compete with cable for the local audience. This competition should not be skewed by what in effect are cable's copyright subsidies.

**Network non-duplication and Syndicated exclusivity rules**

The threat of inequitable competition caused by stations imported from distant markets affects both local independent and network-affiliated stations. For example, in Providence/New Bedford, our station is a CBS affiliate. One of the non-local stations it competes with there on cable is the Boston CBS affiliate. For network affiliates, one of the few remaining FCC cable carriage rules -- the network non-duplication rule -- theoretically provides some protection from this type of imported competition, which can be especially harmful to affiliates located in communities within the shadow of a much larger market.

Under these complicated rules, a qualifying network affiliate that is carried on a local cable system can, upon request, require the system to delete duplicated network programming. In reality, however, this rule provides little protection for local network affiliates. At most, it protects only the network portion of the station's schedule, not the remainder of its programming day. More importantly, because the rule applies only to local affiliates carried on cable, a station will invoke the rule at its peril. Under today's rules, the quickest way for a cable system to resolve a network duplication problem is to drop the complaining station from its system. Without some must carry protection, television stations cannot freely exercise even the few remaining regulations that protect the crucial concept of localism. Television stations must seek to "cooperate" with their local cable systems, which may have little incentive to be cooperative in return.

However, not even that minimal level of protection exists for syndicated programming carried by local stations -- both affiliates and independents. Consider the experience of our Medford/Klamath Falls station. We have purchased the rights to broadcast Cheers, Family Ties, and the new version of Star Trek, in syndicated form. As you realize, these popular shows are very desirable products for local stations, and we have paid handsomely for the exclusive right to broadcast them in Medford/Klamath Falls. Prior to 1980, when the FCC's syndicated exclusivity rule was in place, we would have been able to protect these exclusive rights by requiring local cable systems to delete these shows from any non-local signals they were importing into our market.

The circumstances are far different today now that the syndex rule is gone. Through cable's ability to import distant signals under the compulsory license, and our inability to protect our bargained-for exclusivity, local cable systems also are able to import stations from Portland, Oakland, and

Sacramento, each of which carries all three of these shows. In addition, these systems also carry superstation WGN, which airs Cheers. The audience we draw for these shows is substantially smaller because of this duplication. As a result, the value of our investments in these shows is much reduced. This problem exists to varying degrees with all syndicated programming in which our stations invest.

Protection for broadcasters' exclusive programming rights is essential if we are to be able fairly to compete with cable. Cable recognizes how important exclusivity for its programming is to its competitive future. Unlike television broadcasters, cable is able to acquire exclusive rights to programming. As you already have heard today, it has fought hard to protect that exclusivity against competitors who seek to use its programming. When broadcasters acquire exclusive programming rights, these rights also should be protected within the cable context.

## Incentives to act unfairly against local stations

Thus, cable has many legal and regulatory advantages over local television broadcasters. The mere existence of these advantages should trouble communications and copyright policy makers. Cable, however, increasingly has incentives actually to use those advantages.

As television station owners, our goal is to make our stations' programming as responsive to our viewers' interests as possible. We want strong local programming -- news, public affairs, etc. -- that give our stations a distinct identity with the viewers. As network affiliates, we want our network programming, both news and entertainment, to be as good as possible. We also want to air quality syndicated programming. Cable would have you believe that their programming and carriage decisions are based only on the wants and needs of their subscribers, and the attractiveness of what our stations have to offer to those subscribers. Unfortunately, these are not the only factors that can enter into cable's decisions regarding whether our stations are carried, what other stations and programming services will be carried in competition with us, and where our stations will be placed in a given system line-up.

Cable increasingly is competing with television for advertising dollars. Although cable is a subscription service, many basic cable programming services also are supported by advertising. As with network television programming, some of the advertising spots on these cable services are sold by the services, while they make other spots available for sale by the local systems that carry their programming.

Cable's attractiveness to advertisers is growing. Total cable advertising, national and local, was only $58 million in

1980. In 1987, total cable advertising was more than $1 billion. With cable, both national and local advertising are growing at a substantial rate. Local cable advertising in 1987 was $215 million, a 269% increase from 1984, and a 30.0% increase from 1986.[8]

The mere fact that television increasingly faces competition from cable for advertising dollars is no cause for government concern. If we have a fair opportunity, we will compete for advertising with cable as we do with other media. Cable has been given distinct legal and regulatory advantages over television, however, so that fair competition may not be possible. Cable systems can be programmed in ways that make cable time a more attractive buy for advertisers than television time.

The obvious way a system could encourage advertisers to buy advertising on cable rather than television is to refuse carriage to local stations that compete with the system for advertising. The system could replace a local station with a distant signal that carries similar programming, but with which the system does not compete for advertising. Even if local stations are carried, they can be placed on the less desirable cable channels, while distant stations and the favored cable channels can be placed on the more desirable channel locations.

Cable systems increasingly are clustering popular television stations on channels nearby the channels of the cable services whose viewing (and hence advertising potential) the system wants to promote. Fortunately, our stations have been popular enough -- primarily because of our strong local news programming -- that we are being used as anchors around which cable systems are clustering such cable programming. Many stations, especially smaller independents, are not always so fortunate in their channel positioning. There may come a time when our stations will not be granted favorable locations, either. As cable systems develop their own local news channels, complete with advertising, we may find ourselves subject to strikingly different carriage circumstances.

In addition to the general proposition that all cable systems are increasingly competing with television for slices of the local and national advertising pie, certain cable systems have more direct incentives to favor cable programming over television programming. Segments of the cable industry are becoming more vertically integrated -- some corporations that own cable systems also are becoming more involved with cable program production. Cable systems owned by such companies now may have direct incentives to favor their parents' programming over programs offered by television stations.

For example, one of our stations operates in the Albany/Schenectady/Troy market in New York. In Albany, our station is carried on a system owned by ATC, whose parent is Time, Inc. Time also owns 100% of HBO, 100% of Cinemax, 100% of Festival, 11.5% of the superstation WTBS, 11.5% of CNN, 11.5% of Headline News, 16% of Black Entertainment Television, and assorted other interests. In Schenectady, our same station is carried on a system owned by TCI. TCI also owns 50% of AMC, 10.1% of WTBS, 10.1% of CNN, 10.1% of Headline News, 14% of Discovery, 16% of Black Entertainment Television, 10.5% of the Fashion Channel, and assorted other interests.[9]

This direct relationship between cable program production and distribution is one of the more troubling features of the bumpy competitive landscape over which local television stations must travel.

To summarize my testimony, these are the cards with which the local cable operator can play when he sits down with our stations: He is in at least 50% of the homes in our markets. He can decide to carry our stations or not carry them. He can cherry pick only a portion of our programs. He will not have to bargain for, or pay for, those carriage rights, although he can seek payment from us for carriage. He can decide to carry our stations on our channel numbers, or he can shift them up to the equivalent of the system's "Siberia." He can bring in the same network programming that is carried by our stations, through the network affiliates licensed to the larger cities relatively nearby to our markets. He can bring in distant signals or superstations, which also may duplicate the programs for which our stations have paid a great deal to acquire "exclusive" rights. He competes with us for local and national advertising dollars. He can make any or all of his carriage decisions based on what makes him a better buy for advertisers than our stations.

**The equation between cable and local television stations should be rebalanced**

Regulatory equilibrium between local television stations and cable must be restored. At least two elements are needed for this restoration -- some degree of must carry protection for local television stations, and reestablishment of the syndicated exclusivity rules.

Pending at the FCC is a proceeding which could result in reimposition of the syndex rules. NAB strongly supports such a result. We believe this would restore essential protections for any exclusive rights that broadcasters obtain in the marketplace for syndicated programming.

The must carry issue may be more problematic. NAB and other broadcasting interests are pursuing the legal remedies available to us following the December decision of the Court of Appeals.

NAB believes that Congress also should consider legislation to implement some form of must carriage protection. We feel that properly crafted legislation could withstand a court challenge.

It is premature to predict what form needed legislation should take. One option would be to condition cable's compulsory license on carriage obligations, which would be a matter within the jurisdiction of this committee. NAB currently is working with other broadcasting interests on the many questions involved with this issue. NAB's leadership also is working with representatives of the cable industry to determine whether there are possible areas for compromise.

NAB appreciates this subcommittee's interest in these important issues, and we would welcome the participation of the members in helping to resolve the thorny issues of must carry. As I hope my testimony makes clear, some resolution is required, in order to return a much-needed element of fair competition to the local video marketplace.

## FOOTNOTES

1. WLNE-TV, Providence/New Bedford, RI; WTVC-TC, Chattanooga, TN; KFDM-TV, Beaumont/Port Arthur, TX; KTVL-TV, Medford/Klamath Falls, OR; WRGB-TV, Albany/Schenectady/Troy, NY.

2. Quincy Cable TV, Inc. v. FCC, 768 F.2d 1634 (D.C. Cir. 1985), cert. denied, 476 U.S. 1169 (1986); Century Communications Corp. v. FCC, 835 F.2d 292 (D.C. Cir. 1987).

3. "...the Commission shall make such distribution of licenses, frequencies, hours of operation, and of power among the several States and communities as to provide a fair, efficient, and equitable distribution of radio service to each of the same." 47 U.S.C. §307(b).

4. A.C. Nielsen Company, November 1987.

5. Albany/Schenectady/Troy - 61.5%; Beaumont/Port Arthur - 50.8%; Chattanooga - 53.2%; Medford/Klamath Falls - 58.2%; Providence/New Bedford - 58.3%. Neilsen Station Index, November, 1987.

6. 47 U.S.C. §621(a)(1).

7. For example, franchise fees paid to local authorities are restricted by §622; 47 U.S.C. §622. Local regulation of subscription rates is restricted by §623; 47 U.S.C.§623. Local regulation of services, facilities, and equipment is limited by §624; 47 U.S.C. §624. Denial of franchise renewal is governed by §626; 47 U.S.C. §626.

8. Bob Coen, McCann-Erickson, New York.

9. Broadcasting, "Who Owns What With Whom In Cable Networking," November 23, 1987.

Senator **Metzenbaum**. Mr. Milton Maltz, Malrite Communications Group, on behalf of the Association of Independent Television Stations. Mr. Maltz is an old friend of mine. I am happy to welcome you here.

## STATEMENT OF MILTON MALTZ

Mr. **Maltz**. Thank you very much and good morning, Mr. Chairman. If I could accomplish one thing this morning it would be to focus the attention of Congress on the future of our American system of free and local broadcasting.

I think we all agree that our free broadcast system is a national resource of inestimable value. It serves all Americans, rich, poor, rural, urban. Unfortunately, because of misguided competitive communications and copyright policies, free television is in jeopardy today at the hands of an unregulated monopoly.

It was the Congress that created free broadcasting, from the 1927 Radio Act, to the 1934 Communications Act, to the 1964 all channel receiver legislation, Congress has stressed the substantial Government interest in the maintenance and encouragement of a healthy, free and competitive and local broadcast system.

This morning, sir, I am looking for an answer to this question. Do you still want free broadcasting, or does Congress wish to see in its place a system of pay TV? We urgently need the Congress to focus on this question.

Now, the points developed in my testimony are very simple. First, cable is a monopoly. You do not have to take my word for that. Ask the National Journal, the investment house of Bear-Stearns or read the 1974 Cabinet report to the President of the United States of America. The ownership of these monopoly cable conduits is concentrating rapidly into the hands of fewer and fewer owners.

Now, just last week two major cable companies merged to form the third largest cable company that will in turn be owned by the very largest cable operator, TCI. It is my understanding there now is a cash flow of $1 billion in that organization, or a capitalized market value of between $10 and $16 billion.

These giant cable conglomerates are integrating vertically into the ownership of programming services seeking access through their monopoly conduit. And this vertical integration represents perhaps the greatest threat to competition in the television business today.

Right now we have reached the point, sir, where it is virtually impossible to launch a new satellite-delivered program service without giving up a substantial of equity as tribute to gain passage through the cable gatekeeper.

It is critical for the Congress to understand that as cable increases its program investments and its local advertising sales activity, the cable relationship with local broadcasters is undergoing dramatic transformation. Suddenly, the local broadcaster is viewed principally as an unwanted competitor for viewer's attention and for advertising dollars. If Congress does not act, cable operators will use their control over the monopoly conduit to drive away all competition from local broadcasters.

There is substantial evidence of anticompetitive behavior. New broadcast stations have met with a stonewall of resistance from cable refusing to carry their signals. Existing stations have found their signals routed out of traditional channel positions and relegated to the upper tier, or what we call cable Siberia. These local stations are then replaced with cable program services in which the cable operator holds an equity interest, and/or in which he is selling advertising time.

One of the great ironies of this situation is that all the while as cable is beginning to undermine our free broadcast system, it is simultaneously living off that system. Due to the largess of the Congress, the cable industry enjoys a Government-guarantee to freely use any broadcast programming that is chooses.

The compulsory copyright license stands as a guarantee that cable will never be required to pay for the programming produced or purchased by local stations. The continued existence of this compulsory license, coupled with the absence of local carriage, has created an unstable, untenable, one-way business relationship.

I candidly advise this committee that the future of our American system of free local broadcasting is indeed in grave danger. In 1988, the public does not own the airwaves, a handful of cable operators do.

Mr. Chairman, we need your guidance.

[Material submitted by Mr. Maltz follows:]

# TESTIMONY OF

# MILTON MALTZ

# CHAIRMAN OF THE BOARD & CEO

# MALRITE COMMUNICATIONS GROUP

Thank you Mr. Chairman. My name is Milton Maltz. I am the Chairman and Chief Executive Officer of Malrite Communications Group. Our principal business activity is the operation of radio and television broadcast stations. We currently operate domestic UHF Independent television stations in Cleveland and Cincinnati, Ohio; Rochester, New York; Jacksonville, Florida; and West Palm Beach, Florida. I appear here today in my personal capacity and as the official representative of the Association of Independent Television Stations, Inc., commonly known as "INTV." INTV represents the interests of more than 180 Independent television stations across the country.

It is not my purpose or intention today to attack the character or motives of the cable industry and its leadership. As a businessman, it is difficult for me to criticize others who merely seek to exploit opportunities created by government policies. That would be like scolding a child who had been negligently let loose in a candy store. Instead, my testimony this morning will focus on the patchwork quilt of inconsistent and ill-considered government statutes, regulations and policies that have created the clear opportunity for the cable industry to begin the destruction of our system of free over-the-air broadcasting.

Whatever quarrel one might have with a particular television program or category of programs, it is beyond question that our system of free broadcasting is a national resource of inestimable value to the American people. If that resource is to be preserved, Congress must take at least two immediate actions. First, Congress should condition cable's use of the compulsory copyright license privilege upon a cable operator's voluntary agreement to continue nondiscriminatory carriage of substantially all local free broadcasting stations. Second, Congress should immediately investigate the siphoning of popular American television events from free over-the-air broadcasting to pay cable television channels. The indisputable consumer interest in free television requires prompt Congressional action on these issues.

## I.

## THE CONGRESS SHOULD REQUIRE NON-DISCRIMINATORY CARRIAGE OF LOCAL FREE BROADCASTING STATIONS AS A CONDITION TO CABLE'S USE OF THE COMPULSORY COPYRIGHT LICENSE PRIVILEGE.

### A. Cable has developed as a de facto monopoly.

The starting point for our analysis is a simple fact that cannot be denied. Cable television has developed as a *de facto* monopoly service. The importance of the monopoly nature of cable is dramatically heightened by the fact that many consumers are totally reliant upon cable for their access to television signals.

When the Cable Act of 1984 was being debated, the then President of the National Cable Television Association testified,

> "A consumer will have a couple of choices of cable companies. There will be two cable wires running down the street." [1]

While I am sure that this representation to the Congress was [illegible]de in good faith, it simply did not turn out to be accurate. Of the 7,000 communities in America with cable television service, it has been estimated that approximately 30 or 4/10 of 1% are served by competing systems. Stated another way, approximately 99.6% of all cable subscribers are served by monopoly systems.

It is not only cable's critics that view the industry as a monopoly. The distinguished *National Journal* (7/4/87 at p. 1707), recently commended cable industry lobbyists for inducing "Congress in 1984, to, in effect, deregulate a monopoly." And, the respected investment banking firm, Bear Stearns, has described the cable operators' franchise as "A Monopolistic Annuity."

Cable advocates argue mightily that the availability of other forms of entertainment prevents cable from being considered a monopoly. However, this claim is tantamount to arguing that the telephone company is not a monopoly because people can write letters, or that the electric company is not a monopoly because you can always cook with gas, or that the water company is not a monopoly because it sometimes rains.

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[1] Hearings Before the Subcommittee on Communications of the Committee on Commerce, Science and Transportation, United States Senate, 98th Congress, First Session (February 16-17, 1983), pgs 126-127.

To shed some scholarly light on this debate, INTV, and other interested parties, commissioned the preparation of an economic study entitled "Does Cable Televison Really Face Effective Competition?" This study, prepared by economists Janusz A. Ordover of New York University and Yale M. Braunstein of the University of California at Berkeley is appended as Attachment No. 1 to my testimony. Professors Ordover and Braunstein detail the many factors which lead them to conclude that cable television systems currently do not face effective competition.

Another useful resource on the issue of cable monopoly is the recent article entitled "Antitrust and Regulation in Cable Television: Federal Policy at War with Itself" published in the prestigious Cardozo Arts & Entertainment Law Journal. In this article (appended as Attachment No. 2), author Glenn B. Manishin, Esq. explains how the FCC and the Department of Justice have adopted contradicting and inconsistent positions on the issue of cable competition. The Department of Justice views cable as a "natural monopoly" and therefore finds it inappropriate to engage in traditional antitrust enforcement with respect to the industry. On the other hand, the FCC views cable as subject to "effective competition" and therefore has deregulated the industry. Unfortunately, the interests of consumers in securing the benefits of competition have been allowed to fall through the crack between these two agencies.

## B. Rapid horizontal concentration and vertical integration now provide cable operators with a clear incentive for anti-competitive behavior.

With the Justice Department standing politely to the side, concentration of ownership in the cable industry has proceeded at a furious pace. The largest cable company, TCI, now has a choke hold on television access for approximately 10 million subscribers. Just last week, two large MSO's, United Cable and United Artists Cablevision, announced a merger. The merged company will be the third largest MSO and will be controlled by TCI, the largest cable operator.

While the industry is concentrating horizontally, cable operators have moved rapidly to integrate vertically into the ownership of some of the program services seeking access to the home through the monopoly cable conduits. Appended as Attachment No. 3 is a recent trade press article that describes the trend toward vertical integration.

This vertical integration has produced a profound change in the nature of the cable industry. Cable operators are no longer merely passive and disinterested retransmitters of broadcast programming. Through their equity interest, and through the sale of local advertising availabilities, cable operators now have a clear vested interest in the competitive success of some of the programming services seeking access through their conduit. You don't need a Ph.D. in economics to figure out that the guy who controls a monopoly conduit is in a unique position to control the flow of programming traffic to the advantage of the program services in which he has an equity investment and/or in which he is selling local advertising availabilities, and to the disadvantage of those services, including local broadcasting stations, in which he does not have an equity position.

As our laws stand today, a telephone company is prohibited from owning a cable system for fear that it might "favor[ing] its own or affiliated interest as against nonaffiliated interests...." Section 214 Certificates, 21 FCC 2d 307, 324 (1970). And, a broadcast station is prohibited from owning a cable system to prevent it from gaining "a competitive advantage" over other stations. CATV, 23 FCC 2d 816, 820 (1970). But, cable operators are permitted to integrate vertically, and use that integration to gain a competitive advantage over others seeking access through their monopoly conduit.

The anti-competitive potential inherent in common ownership of the cable conduit and program services was clearly recognized in the 1974 "Cabinet Report to the President" by the Cabinet Committee on Cable Communications. A copy of that report is appended as Attachment No. 4 to my testimony. The Cabinet Committee expressed its competitive concerns in the following terms:

> "Cable's multi-channel technology, together with the economic imperatives of a medium that is a natural monopoly, could lead to an even greater concentration of power than exists in broadcast television. When a single cable operator has the power to control the

> programming and information content of all the channels on his system, his monopoly power over the cable medium of expression is nearly absolute."

The solution chosen by the Cabinet Committee was a recommended separations policy. The Committee described its proposal as follows,

> "We recommend adoption of a policy that would separate the ownership and control of cable distribution facilities, or the means of communications, from the ownership and control of the programming or other information services carried on the cable channels."

Somehow, the thrust of this compelling report was lost in the rush to pass the Cable Act of 1984. As a result, local broadcasters and consumers now face a vertically integrated monopoly cable industry with a clear incentive to engage in anti-competitive behavior. For example, in New York City, 50 consumers recently were forced to bring a private antitrust action in order to gain access to program services other than those owned by their monopoly cable operator.2/

C. Despite some voluntary restraint, there is clear evidence of anti-competitive cable behavior.

As I stated at the outset of my testimony, it is difficult for me to be too critical of an entrepreneur simply for taking advantage of anti-competitive opportunities presented by our current legal and regulatory structure. In fact, the cable industry deserves some credit for exercising admirable voluntary restraint under the circumstances. Many cable operators have heeded the advice of their leaders not to invite re-regulation by precipitous action.

However, there is now unmistakable evidence of the natural and inevitable anti-competitive consequences of our badly skewed cable marketplace. Cable operators now view new commercial Independent broadcasting stations as little more than unwanted competition for viewers' eyeballs and advertisers' dollars. As a consequence all across the country new stations have met with a virtual stonewall of opposition from cable operators who have refused to add these new stations to their service offerings. For example, my company was forced to seek the intervention of a member of Congress in order to secure carriage of our Cleveland station on one area cable system.

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2/ Appended hereto as Attachment No. 5 is a story from "The Village Voice" describing this litigation.

Cable industry resistance has contributed significantly to the bankruptcy of 23 new Independent television stations.

Existing stations have fared only marginally better. All across the country, cable operators have shifted local free broadcasting stations out of their traditional cable channel positions. The free broadcasters are typically relegated to undesirable channels at the upper end of the UHF spectrum ("cable Siberia"), which cannot even be received by all cable subscribers. The desirable low number channel positions, formerly occupied by the local broadcasters, are now filled with cable program services in which the cable system owner has an equity interest, or in which he is selling advertising availabilities.

These channel shifts cannot be defended on the basis of consumer preference. In virtually every case, the cable program service which has replaced a local broadcaster has a lower audience rating than did the displaced station. Since many consumers have no practical alternative to cable service, cable operators have been and remain free to make these channel shifting decisions without regard to consumer preferences. Appended to my testimony as Attachment No. 6 are copies of newspaper accounts of consumer complaints regarding these channel shifts.

Cable operators also have engaged in the anti-competitive practice of "tie in" sales. Previously, consumers had the option of purchasing only the retransmission of local free broadcasting signals. Since deregulation however, the cable industry has engaged in what it, itself, describes as "tier meltdown." In the process, access to local broadcast stations is "tied" to subscription to other cable program services. In other words, in order to gain access to their local broadcast stations, consumers are *required* to purchase the cable operator's program services. The state of West Virginia, on behalf of its citizens, has recently brought an antitrust action to invalidate these "tie in" sales. *State of West Virginia* v. *American Television & Communications*, Cir. Ct., WVA Civ. Action No. St-C-659.3/ Obviously, it places a great burden on consumers to require them

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3/ See Attachment No. 7

to pay for cable program services, which they may not wish to purchase, just in order to gain access to their local free broadcast stations.

D. The cable compulsory copyright license impacts heavily on these competitive issues.

The cable industry continues to enjoy the extraordinary privilege of a compulsory copyright license to use broadcast programming. This license has two distinct parts relating to local and to distant broadcast signals. The local compulsory license provides the cable operator with a government guarantee of free use of all of the programming purchased or created by local broadcasters. The license is a government guarantee that a cable operator will never be denied the right to use the programming any local stations. Nor can the cable operator ever be charged by any local station for the use of its programming.

Cable operators pay for the use of cable program services, such as MTV, but do not have to pay for the use of local broadcast signals. When you consider that cable subscribers spend most of their time watching broadcast signals, the value of this subsidy to the cable operator becomes clear. Because of the compulsory license, cable has become a business that can never be required to pay for a major part of what it is that it sells to consumers.

Some cable program services have begun to provide discounts in the charge they impose on the cable operator in order to secure more favorable channel positions. The local broadcaster cannot "meet the competition" by offering a discount, since he is prohibited from imposing any charge in the first instance.

The cable operator also receives a compulsory license to import the signals of distant broadcast stations. For these distant signals, the cable operator pays a statutory license fee into a pool which is divided among copyright owners. Local broadcasters must purchase their programming at marketplace prices. Cable operators can secure the very same programs on distant signals for government prescribed discount prices. The competitive inequality of this situation is both obvious and intolerable.

E. Cable's use of the compulsory license for local signals should be conditioned upon a non-discriminatory carriage requirement.

Two different sets of mandatory local cable carriage rules have been declared unconstitutional by Appellate Courts. Petitions for Supreme Court review of these decisions are now pending. However, it seems prudent to explore a more constitutionally secure approach to the issue of cable carriage of local signals.

Our Association supports an approach in which the cable operators' continued use of the free compulsory license for local signals would be conditioned upon his voluntary agreement to a reasonable non-discriminatory carriage requirement. By agreeing to carry substantially all local stations, the cable operator would continue to enjoy a free compulsory copyright license to retransmit local signals. On the other hand, cable operators who wished to do so would be free to discriminate in the carriage of local stations subject to normal copyright liability for those stations they wished to retransmit.

The key to this approach is that cable operators clearly do not have a constitutional right to a compulsory copyright license to use broadcast programming. By enacting such legislation, Congress would insure that the compulsory copyright license privilege it has created does not become an instrument for discrimination among local stations licensed to serve the same area.

The Congress may also wish to prohibit the "tie in" sale of local broadcast retransmission services and cable program services. Clearly, consumers should have the option of purchasing only broadcast retransmission services.

## II.

## CONGRESS SHOULD INVESTIGATE THE "SIPHONING" OF POPULAR EVENTS FROM FREE BROADCASTING TO PAY CABLE SERVICES.

I have enormous respect for the new and diverse viewing alternatives that the cable medium has provided to the American public. Cable provides consumers with choices previously unavailable including 24 hour news, coverage of Congressional proceedings and sporting events not previously telecast on free over-the-air broadcasting. The availability of these additional viewing choices provides a clear benefit to consumers.

However, consumers clearly will not benefit, but will be substantially harmed, if programming and events previously available for free on broadcast stations are "siphoned" away to pay cable services. Plainly it does not benefit consumers to require them to pay for exactly the same program events which previously had been available to them for free.

There is clear evidence that this process of "siphoning" has already begun. Eleven NFL Football games which had been carried on free television in previous years were available only on a pay cable channel this past season. Millions of working men and women were deprived of access to television coverage of these eleven NFL games. If I have ever seen the head of the camel under the edge of the tent, this is it.

Appended to my testimony as Attachment No. 8 is an editorial from Cablevision Magazine which gleefully reports that the Congress did not react to the loss of these NFL games from free television. As noted in the editorial, cable industry leaders now talk openly of "siphoning" the World Series, the Super Bowl and the Olympics from free television to pay cable channels.

Last summer saw a drastic reduction in the number of Yankee baseball games on free TV. The missing games were siphoned away to a pay sports channel while the cable industry continued to live off of the free broadcast system. In October of this year, Turner Broadcasting Company is slated to commence a new cable program service to be called Turner Network Television ("TNT"). As outlined in numerous press accounts (samples of which are appended as Attachment No. 9 to this testimony), the goal of this new service is to siphon away exclusive coverage of major American events from free television. Included on the target list are Major League Baseball, the Masters Golf Tournament, the Kentucky Derby, the Miss America Pageant and many other major events that are a part of the social fabric of this nation.

Obviously, free over-the-air broadcasters such as Milton Maltz have an economic self-interest in preserving free broadcasts of these events. However, our economic self interest does not in any way diminish the manifest public interest in assuring continued free over-the-air access to these staples of our American culture.

The survival of free television is an issue which we believe should command the immediate attention of the Congress. At the very least, Congress should commence an investigation into the prospect that the American people are about to be made to pay to see events which previously had been available to them for free. Following that investigation, it may be possible to craft conditions upon the compulsory copyright licensing privilege and/or the antitrust exemptions heretofore granted to certain sports interests, as a means of assuring that consumers are not requried to pay for access to events which they currently enjoy for free.

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Mr. Chairman, I believe that you are well aware of the enormous respect that I hold for you and for your legislative record. I would not insult you and your colleagues by sitting here this morning and making "Chicken Little" predictions. I honestly believe that the future of free television is in serious jeopardy. Our stations, our programming and our service to consumers cannot long withstand the relentless onslaught of anti-competitive behavior by unregulated monopoly cable systems. I don't blame the cable entrepreneurs for seizing the opportunities available to them. However, I do believe that the government has an obligation to review its competitive, communications and copyright policies to assure that consumers continue to have access to the free television services that represent an important part of life in American today. Thank you.

Attachment No. 1

# Does Cable Television Really Face Effective Competition?

Janusz A. Ordover
Professor of Economics
New York University

with the assistance of

Yale M. Braunstein
Professor
University of California at Berkely

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# Does Cable Television Really Face Effective Competition?

Janusz A. Ordover[1]

## Introduction

Is cable television a local monopoly or does it face effective intramodal and intermedia competition? An answer to this question must be given before sound public policy toward cable television can be devised. In 1985, the FCC concluded that cable television faces effective competition from broadcast television in those local communities where there are at least three off the air television signals available to television viewing households in any portion of a cable community. The Commission found that the availability of three broadcast television signals is enough to ensure an effective competitive constraint on the ability of a local cable system operator (CSO) to charge "noncompetitive" rates and to offer a less than desirable programming mix to subscribers.[2] This "three signals" conclusion was used to implement the rate deregulation provisions of the 1984 Cable Act,[3] that is, where effective competition in the form of three broadcast signals exists, cable firms may charge as much as they wish for basic service.

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1/ Janusz A. Ordover is a Professor of Economics at New York University. Yale M. Braunstein, Professor, University of California at Berkeley contributed to the preparation of this analysis.

2/ Implementation of the Provisions of the Cable Communications Policy Act of 1984, 50 Fed. Reg. 18637 (1985).

3/ The Cable Communications Policy Act of 1984, Publ. L. 98-549, 98 Stat. 2779 (1984).

We have been asked to review critically the Commission's findings regarding the extent of effective competition between cable and broadcast television. Our analysis has two main purposes. First, to ascertain whether the methodology used by the FCC to reach its findings is consistent with widely accepted precepts of economic analysis, based on current conditions, and reflective of a sufficiently broad range of considerations. Second, to review the scant data from the deregulated cable markets in order to gauge the likelihood that cable faces competition where three broadcast signals are available.

We do not aim here to provide a rigorous statistical test of intermedia competition or to provide a detailed forecast of the likely effects of deregulation on the cable industry. Such an exhaustive undertaking would be impossible in the limited amount of time available to prepare this report. Nevertheless, we have reached certain conclusions. These are summarized as follows:

> First, the analytic methodology used by the FCC to gauge the extent of effective competition between cable and broadcast television did not conform to widely-accepted economic methodologies.
>
> Second, the cable industry has been undergoing rapid structural and other changes which potentially cast doubt on the validity of the "three signals" finding (which was based on data from 1984 and earlier).
>
> Third, presumably because of its perception of broadcast TV as the main constraint on cable television, the FCC has understated the social value of alternative video technologies, such as wireless cable or MMDS, SMATV, and DBS.
>
> Fourth, the available, albeit scant data indicates that the only unambiguous gainers from cable

rate deregulation have been holders of local franchises.

Fifth, future analysis of competition issues requires substantially more fact-finding and sounder methodologies than employed by the FCC.

## 1. FCC's Analysis of Effective Competition Suffers From Fundamental Methodological Problems

A scrutiny of the analytic approach adopted by the Commission in support of its "three signal" rule reveals significant methodological flaws. These flaws cast grave doubt both on the validity of the conclusions and on the desirability of the rule itself. We shall argue that the methodology adopted by the Commission in deriving criteria for "effective competition" in the cable television market is not based on standard economic indicia or substitutability among various entertainment/information services.[4] In fact, it appears that the Commission first formulated the desired policy conclusion and then sought to develop data that, if it did not prove the conclusion, at least would not undermine the conclusion.

The Commission's major premise apparently is that cable television competes in a broadly defined "home video market" in which cable, over-the-air television, STV, MDS, SMATVs, and DBS, "all offer alternatives that appear to be perceived as substitutes."[5] This approach would be based essentially on the observation that a variety of media deliver "information and entertainment" to the public. Thus, the FCC's approach hypothesizes a broad market in which cable television allegedly competes for the viewers' attention and dollars against VCRs, AM-FM radio, movie theaters, print media, and so on. It appears, furthermore, that in constructing the relevant product market, the FCC failed to give adequate consideration to such important considerations as the multichannel capacity of cable systems and cable's ability to provide packages of programming to subscribers.

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[4] Thus, we concur to some degree with the comments filed by the U.S. Dept. of Justice. See Comments of the U.S. Dept. of Justice, MM Docket No. 84-1296, January 28, 1985.

[5] This is a view advanced by economists Jonathan D. Levy and Peter K. Pitsch in their article "Market Delineation, Measurement of Concentration, F.C.C. Ownership Rules," p. 203, in V. Mosco (ed.), Policy

The Commission's approach begs a fundamental question which goes to the heart of public policy toward cable television. This is: Do alternative technologies for delivering video programming actually provide effective competition to cable? Effective competition cannot be engineered by assumption. Strength of competition has to be assessed using sound economic methods, such as those outlined below, which conform to the criteria suggested by the Department of Justice.

Instead, in its analysis the FCC merely assumed a broad product market in which cable television competes with broadcast television (and other media). It then proceeded to determine how much competition is needed in that product and

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Research in Telecommunications, Ablex Publishing Corp. (1984), pp. 201-212. See also Levy and Pitsch, "Statistical Evidence of Substitutability Among Video delivery Systems," in E. Noam (ed.), Video Media Competition: Regulation, Economics, and Technology, Columbia University Press, (1985), pp. 56-92.

geographic market to offer effective competitive constraints on the market power of cable system operators. The Commission concluded that the theoretical presence of three broadcast television signals of adequate quality reception would sufficiently restrain whatever market power a cable system operator ("CSO") might have.

Apparently the number three was reached on the basis of empirical studies showing that adding a fourth broadcast TV station to a market does not have a statistically perceptible effect on basic cable subscription levels.[6/] This approach was pioneered some time ago by John Kwoka.[7/] He demonstrated that in certain instances the creation of a strong third-ranked firm out of two lesser-ranked firms could cause prices to fall despite an increase in measured market concentration. Regardless of the econometric and analytic merits or demerits of Kwoka's study,[8/] it is certain that his work did not answer what

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[6/] The Commission's order refers to a study by NCTA/CATA "providing factual support for a standard based on fewer than three signals." ¶ 97. It also cites Arbitron data showing that in two signal markets cable viewership of off-air signals was equal to or greater than off-air viewership of such signals. The opposite was found to be true of three signal and greater markets. ¶ 99. The report assumes that cable itself is the fourth competitor in a three-signal market. Interestingly, none of these findings goes directly to the issue of effective competition between cable and broadcast TV.

[7/] See J.E. Kwoka, "The Effect of Market Share Distribution on Industry Performance," The Review of Economics and Statistics, 1, 1979, pp. 101-109.

[8/] For a criticism of Kwoka's study, see W.F. Meuller and D.F. Greer, "The Effect of Market Share Distribution on Industry Performance Reexamined," The Review of should be the key question: whether the presence of three broadcast television stations in a geographical market ensures that prices and "clusters" of cable services offered by a CSO reasonably well approximate the social ideal. Kwoka showed only that a current level of price may fall following the creation of a strong third or fourth player. Kwoka's findings necessarily apply only to markets (or industries) that deviate from a fully competitive ideal[9/] so that the current level of price generates rents to the leading firms. This is because if the market were highly competitive (or fully contestable), the price could not fall any further as a result of increased concentration.

The relevance of the Kwoka-type analysis to the public policy issues regarding media market power is very limited. This analysis fails to consider whether three broadcast stations and one cable operator actually make for an adequately competitive market. Instead, it merely suggests that the presence of a fourth broadcast TV station does not necessarily make for a comparatively more competitive market than a market comprising three broadcast TV stations and one cable system.

The FCC's conclusion regarding effective competition is thus troubling. It is also surprising in

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Economics and Statistics, 2, 1984, pp. 353-357.

[9/] Kwoka's results also apply to markets which are not perfectly contestable. Baumol, W.J., J.C. Panzar, and R.D. Willig, Contestable Markets and the Theory of Industry Structure, Harcourt Brace Javanovich, 1982.

light of the availability of an appropriate conceptual method of analysis developed by the Antitrust Division of the Department of Justice in the 1982 Merger Guidelines.[10/] In fact, this is the very methodology that the Department urged the FCC to adopt in implementing the Cable Act.

Conceptually, the Guidelines methodology can be readily applied to the problem of determining the degree of effective competition between cable television, on the one hand, and broadcast television (or other media) on the other hand.[11/] In essence, following the Guidelines methodology,

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[10/] DOJ Merger Guidelines methodology for constructing relevant product and geographic markets can be summarized in a sequence of steps. Step 1: determine a product or service whose pricing and quality are to be analyzed. Here, the relevant product or service may be basic cable or cluster of services provided by cable systems. Step 2: Determine the relevant suppliers in a given geographic area. Here, the relevant supplier will be the monopoly cable franchise, in most cases. Step 3: Determine which products or services constrain the ability of firms identified in Step 2 to profitably elevate the relevant prices above some chosen benchmark level by a small but significant amount for a nontransitory period of time. In most situations examined by the Antitrust Division, the hypothesized price increase used has been 10 percent and the nontransitory period of time has been pegged at two years. However, in some limited circumstances, the Division used smaller (5%) and larger (15%) price increases. Step 4: Construct the relevant market comprising firms identified in Steps 2 and 4. See, J.A. Ordover and R.D. Willig, "The 1982 Department of Justice Merger Guidelines: An Economic Assessment," 71 California L. Rev. 535 (1983), for a more detailed analysis of the pertinent methodology. 1982 Merger Guidelines, 47 Fed. Reg. 28,493 (1982) and 1984 Merger Guidelines, 49 Fed. Reg. 26,823 (1984).

[11/] For an example of application of the Merger Guidelines in video markets, see Lawrence J. White, "Antitrust and Video Markets: The Merger of Showtime and the Movie Channel as a Case Study," in E. Noam (ed.), Video Media Competition: Regulation, Economics, and Technology," we would say that the availability of broadcast television contemplated under the Commission's standard offers effective competition to cable television if, following decontrol of basic rates, cable system operators would find it unprofitable to elevate basic rates by 10 percent and maintain them at this higher level (in real terms) for at least two years. It is theoretically possible, of course, that such a rate increase might be unprofitable in markets with three or more broadcast television stations (as the Commission asserts) and profitable in franchise areas in which there are fewer than three broadcast television stations. However, the analytic studies that are available suggest that the Commission's definition of effective competition is probably wrong.[12]

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Columbia University Press, (1985), pp. 338-363.

[12] A study by G. Kent Webb, The Economics of Cable Television, Lexington Books, (1983), found that basic cable penetration increases with the number of off-the-air channels it carries, suggesting that to some extent basic cable services and broadcast television are complements. However, improvements in the quality of broadcast television tend to reduce basic's penetration, other factors remaining the same. Thus, on this score, the two media are substitutes, at least to a limited extent. Webb's study strongly suggests that it is pay cable which competes with broadcast television. Obviously, to the extent that the potential subscriber must pay basic rates before obtaining premium services, the price of basic affects demand for premium services. It is difficult to know what one should make of Webb's results. From our standpoint, however, the key question is the price elasticity of demand for cable services as a "function of" the number and quality of broadcast television stations. Webb's results suggest that no matter what is the actual numerical value of this elasticity, it is likely to be small. A recent study by Browne, Bortz and Coddington, as reported in Cable TV Franchising, Paul Kagan Assoc., July 20, 1986, p.3,

Indeed, the Commission may have misunderstood the most basic phenomenon of the cable industry. Namely, it is possible that broadcast TV viewers have been defecting to cable TV,[13] so that cable may be constraining broadcast TV, as the Commission appears to believe. Yet it does not follow necessarily that broadcast is effectively constraining cable television at current cable rates and program offerings.

How realistic is it that a price increase of a magnitude of ten percent in current subscription rates would prove unprofitable to a cable system operator? Some important insights can be obtained by making an assumption about a representative CSO's mark-up on average subscriber charges, that is, CSO's variable cost to price margin.[14] Straightforward calculations used for illustrative purposes show, for example, that when the cost to price ratio margin is one over three, a 10% rate increase would be unprofitable if it were to induce as much as fifteen percent reduction in penetration. The one over three cost to price ratio means that the variable cost (averaged among all disconnecting subscribers) would be a third of the average subscription

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supports this suggestion.

[13] See, for example, M.O. Wirth and H. Bloch, "The Broadcasters: The Future Role of Local Stations and the Three Networks," p. 121-122, in E. Noam (ed.), Video Media Competition: Regulation, Economics, and Technology, Columbia University Press (1985), pp. 121-137.

[14] Note that an increase in a basic rate may induce some disconnections among those subscribers who also purchased pay tiers. It is for this reason that we must focus on an average mark-up.

rate.[15] Inspection of the mathematical formula indicates that the higher the cost-price ratio, the less likely it is that a 10% price increase would prove unprofitable because of the number of disconnects it induced. [See Appendix A1 for calculations based upon various cost - price ratios and rate increases.]

The available data indicate that the variable cost components for basic services are a small percentage of revenue from basic, perhaps as low as 9%.[16] On the other hand, these costs can be as high as 50% for premium programming services. In light of these facts, our illustrative ratio is not unreasonable. The available evidence also tends to suggest that price increases of this magnitude did not cause a substantial reduction in cable's penetration in those communities that already have cable, although the real magnitude of these price increases must be adjusted in some cases by accounting for changes in the offerings included in various basic (or first) tiers. (*See* section 2a infra.) As shown in Table 1, nationwide cable penetration increased in the first quarter of 1987.

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[15] The mathematics are as follows. The change in profits, denoted by $dL = p\,q[(dp/p) + (dq/q)(1-[\text{variable cost}/p])]$, where $p$ denotes subscription rates and $q$ the number of subscribers. We fix $dp/p$ at 0.1 or 0.15 and fix the price-cost ratio at some appropriate level and then calculate $(dq/q)$ that would cause the change in profits to be negative.

[16] Two caveats are necessary here. First, the variable costs are low because most of the investment is either sunk or fixed. Consequently, long-run variable costs may be higher than those postulated in the text. Second, as discussed in section 1(b)(i), basic is undergoing an unprecedented transformation in the present marketplace.

### 2. FCC's Analysis of Effective Competition is Outdated In View of Significant Programming and Structural Changes in the Cable Industry

The FCC's 1985 conclusion is also potentially flawed because the market it examines is already antedated. A new picture of that market suggests strongly that cable has the ability to obtain monopoly rents. The most important elements of the new picture are "tier meltdown" and structural changes in the degree of horizontal and vertical integration.

#### a. Tier Meltdown.

During the last few years, CSOs have tended to include more attractive programming choices in the basic tier. This is in contrast with the early days of classic 12-channel cable systems when the basic service included principally (1) must-carry stations (the locally available broadcast TV signals), and (2) some locally originated programming. In fact, in many early systems only a single basic tier was available to subscribers.

Subsequently, cable operators began using microwaves to import distant television signals for retransmission. With the advent of satellites, additional program offerings, such as HBO, The Movie Channel, Showtime, etc., were made available in cable systems on pay-per-channel basis. Cable systems acquired greater channel capacity which enabled them to increase their offerings. In turn, growing channel capacities stimulated new programming. Ironic, but pertinent for public policy, is the fact that channel space for new offerings is now scarce in some cable systems.

During that period, which lasted until quite recently, the economics of cable television pricing were driven by the presence of demand-interdependencies among various offerings of cable services. In particular, a CSO had to allow for the fact that changing the price of basic service increased the actual price (thereby reducing demand) for premium services. CSOs thus employed sophisticated price discrimination strategies that enabled them to maximize revenue from subscribers of different tastes. In addition, and perhaps of equal importance, because subscription rates for pay tiers were by the mid 1970s almost totally deregulated and were often not included in the base for franchise fees, the CSOs sought to shift as much programming as possible into higher (premium) tiers to maximize their pricing freedom and net revenue.

In the wake of the 1984 Cable Act, cable operators have begun to increase the number and variety of offerings that are included in basic. As a result of this new marketing strategy, the basic tier now offers not only retransmission (i.e., higher quality reception of broadcast TV), and local programming, together with a "right" to purchase higher tiers, but also increasingly varied and better quality programming. The ongoing simplification of the pricing of basic and premium services by cable systems is due to a combination of factors. The most important of these are:

(i) customer resistance to and confusion with complex tiering of services;

(ii) changing offerings as program suppliers enter and exit the supply side of the distribution chain, resulting in periodic realignments of tiers;

(iii) vertical integration of cable and program suppliers;

(iv) increased power of cable system operators in negotiations with franchising authorities. This has resulted from two events: (a) the end of the "franchising wars," and (b) deregulation and preemption by Congress.

Overall, through increased clustering of offerings in basic tiers, the trend has been to reposition these tiers in the product space of information and entertainment services. It is difficult to determine with precision the consequences of that repositioning on effective competition among the providers of video-based entertainment and information. In our opinion, repositioning potentially has eased the constraint, if any, that broadcast television imposes on basic cable. This is because strategies designed to reposition products (here cable offerings) are primarily motivated by the desire to reduce the degree of head-on competition, not to enhance it. In brief, basic cable still subsumes broadcast, but its reshaping has made it a distinguishable product.

As a product, basic cable now is the availability 24 hours a day and seven days a week of all of the following: news (including the specialties of financial, sports, weather, headline, feature, live, local, and general national news), sports (of different sports and multiple games within most major sports), children's variety, adult variety, religious offerings, shopping (ranging from fashionable clothes to bizarre geegaws), and movies. In terms of the continuous availability of this smorgasbord of programming, no three broadcast stations, even taken as a group, can compare; basic cable offers a distinct product.

Thus the product market that was considered by the FCC prior to its deregulatory rulemaking has changed. It is probably less competitive than it was then,[17] but at least the Commission ought to re-examine the marketplace. In doing so, the Commission should use better methodologies, and should determine the implications of product repositioning and tier meltdown on the degree of effective competition among different modes of reaching the television-viewing public.

b. Structural Changes.

Perhaps of even greater consequences for public policy are the structural changes in the cable industry since the passage of the Cable Act of 1984 and the FCC's 1985 deregulation ruling. These structural changes include both increasing concentration in cable ownership and increasing vertical integration between CSOs, program distributors, and production companies. Concurrently with this trend towards increased horizontal concentration and tighter vertical links in the programming-distribution chain, cable system operators have at times implemented programming practices whose impact on competition is potentially suspect.

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[17] In the DOJ Comments, it was concluded at 18 that ". . . broadcast television is generally not a good substitute for the full range of programming and other services distributed by cable television. These reasons include the large variety of video programming usually carried on cable systems (. . . .) and the inability to market 'pay' services successfully over broadcast television." DOJ at 18.

(i) Horizontal Integration.

Some consolidation of the ownership of cable systems took place prior to deregulation. It seems, nevertheless, that deregulation -- combined with favorable merger policy and a rising stock market -- greatly spurred the trend towards consolidation of ownership in the cable industry. Recent estimates indicate that of all cable subscribers (more than 40 million households), 46 percent are directly or indirectly controlled by 5 companies.[18] In 1985, the top 50 companies accounted for 70 percent of the nation's nearly 35 million subscribers. The two major MSOs, Tele-Communications Inc. (TCI), and American Television and Communications Corp. (ATC), now control approximately over 30 percent of all subscribers, with TCI alone controlling 22 percent. The biggest MSO is TCI which owns 600 cable systems with approximately eight million subscribers in 44 states. The second largest MSO, ATC (a subsidiary of Time, Inc.), owns 660 cable companies with 3.5 million subscribers in 32 states. TCI alone has spent nearly $3 billion acquiring over 150 cable systems in the last three years.

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[18] These figures are culled from various issues of Cablevision.

It has been estimated that, in 1986, approximately nine billion dollars was spent on mergers and acquisitions by the largest MSOs. One industry official has commented that it would not be surprising to see as many as five to eight of the top 20 companies disappear through horizontal integration of the next five years.[19/]

This trend towards increasing concentration has not been appreciably slowed by the rising prices of the transactions. In 1986, the average per subscriber value of one company's acquisitions, for example, was $1399 and the cash flow multiple on a projected first year basis was 10.5. For another company, the average value per subscriber was $1254. In some key targeted cable areas, i.e., Florida and California, prices of $2000+ per subscriber are not uncommon. Prices in 1986 generally averaged between $1200 and $1300 per subscriber. However, prices ranged widely from $900-$1200 for the very few remaining classic (i.e., older systems with only small capacities which typically offer only broadcast stations) cable systems to $1500+ for large or underdeveloped systems. And by 1987, the per subscriber prices have gone into the $2000+ range, according to trade press reports. In contrast, in 1984 (prior to cable deregulation), cable systems could typically be acquired for $800-$900 per

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[19/] These estimates were reported in Cablevision, January 19, 1987.

subscriber. As of late 1985, the going price was reported to be $1100-$1200. The strong per subscriber prices were also reflected in the average projected first year cash flow multiple paid for systems in 1986, the average of which ranged from 10.5 to 11.5.

There is very strong reason to suspect that deregulation made it possible for CSOs to better extract profits from their local franchises. To the extent that there is no evidence that, on average, CSOs were unprofitable (on a replacement cost basis) prior to deregulation, deregulation must be strongly considered as an important explanatory variable behind the increases in per-subscriber prices paid by the purchasers.

The available financial data on the sales prices of cable franchises can indirectly be used to obtain some estimates of the degree of monopoly power held by local cable franchises. One analysis looks at the ratio of the value of the productive asset in the financial market to its replacement value. This ratio is high when the asset has market power attached to it. In particular, in highly competitive markets the ratio -- denoted as the q-ratio -- should approximately equal one. Based upon an analysis of 153 recent sales of cable systems, Shooshan and Jackson Inc. have calculated q-ratios for 1986.[20/] Their study estimates

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[20/] Shooshan and Jackson, Inc., "Opening the Broadband Gateway: The Need for Telephone Company Entry into the Video Services Marketplace," (1987), Washington, DC, submitted in FCC CC Docket No. 87-266.

the q-ratio for the cable industry as of December 1986 at 2.81.[21] Obviously, in light of additional increases in the per subscriber acquisition prices in 1987, the value of the q-ratio has increased substantially as well.[22] The study concludes that the explanation for the high q-ratio is that the cable industry has excessive market power. Thus, these analysts conclude that although there are many potential and actual alternatives to cable, these alternatives do not adequately constrain the monopoly power of cable systems.

(ii) Vertical Integration

Another dramatic manifestation of structural changes in the cable industry is the growing degree of vertical integration. "Forward" and "backward" vertical integration has been taking place. Thus, MSOs have been integrating into programming.

Vertical integration by major MSOs into programming services is linked with the concentration of system ownership.[23] This is because large MSOs have assured captive subscribers which reduces the risks of substantial investments in programming.

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[21] This ratio is what Shooshan and Jackson call their middle-of-the-road estimate. They also calculate two other estimates: one with a high adjusted replacement cost and the other with a low adjusted replacement cost. The q-ratios for these estimates are 2.27 and 3.28, respectively. The q-ratio for a competitive market is equal to one. Higher q-ratios occur in concentrated industries where there are barriers to entry and there are few mechanisms to reduce monopoly profits.

[22] As we pointed out, however, the general increase in stock market prices over the 1984-87 period contributed to the increases in the calculated q-ratio.

[23] See, e.g. Lawrence J. White, "Antitrust and Video Markets: The Merger of Showtime and the Movie Channel as a Case Study," in E. Noam (ed.), Video Media

Interestingly, for a programmer the audience base provided by cable is more secure than is the audience when the programming is delivered via broadcast. An advertising-supported delivery technology must be sensitive to the size of the viewing audience for every minute of programming. By contrast, the analysis for a CSO of the value of any programming turns on whether a particular service increases penetration, not how much (or even whether) anyone watches that service. Another way of making this point is to note that the product delivered by cable to consumers is the continuous availability of a range of programming, but the product broadcast TV claims to its advertisers that it delivers to consumers is an audience measured by the number that actually watches a given program. The audience size obviously fluctuates more widely than does the number of subscribers.

At the same time, vertical integration may be welcome to a programmer that has experienced the substantial buying power (monopsony power) of large MSOs, with their unchallenged grip over cable subscribers. Indeed, it is well-known that large MSOs frequently pay dramatically lower per subscriber fees than those paid by smaller systems.

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Competition: Regulation, Economics and Technology, Columbia University Press, (1985), pp. 338-363.

This is not the place to explore in detail the extent of vertical integration in the industry and the ongoing changes. However, as can be seen from Tables 2 and 3, several of the largest MSOs are owned by media corporations who are among the largest cable programmers. Many of the cable system operators and the program packagers also have interests in program production and other aspects of distribution. Furthermore, data indicate that subscribers to the cable systems operated by vertically integrated firms are most likely to subscribe to each firm's jointly-owned pay service.[24/]

Economists generally presume that vertical integration and vertical business practices are driven by efficiency considerations.[25/] However, whether a quest for efficiencies fully explains vertical integration in the cable industry, as well as some other programming practices, has yet to be fully explored. Indeed, economists have recently

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[24/] See B.M. Compaine, Who Owns the Media, Second edition, White Plains: Knowledge Ind. Publ. (1982). See also, Shooshan and Jackson, Inc., Economic Analysis of Concentrated Ownership of Cable Systems, Washington, D.C., 1986, and "Cable TV: The Issues," Consumer Reports, September 1987.

[25/] See, e.g., M.K. Perry, Vertical Integration: Determinants and Effects, Bell Corporation (Belcore) Research Paper (June 1987) and M.L. Katz, Vertical Marketing and Franchising Agreements, UC Berkely Bus. School (September 1987) both forthcoming in R. Schmalensee and R. Willig, Handbook of Industrial Organization, North-Holland Publishers (1988).

pointed out that, at least in principle, vertical practices can have anticompetitive horizontal consequences.[26/]

Thus, for example, through vertical integration MSOs may deny programming to alternative cable technologies, such as MMDS ("wireless cable"), which constitute a head-on threat to cable's control of the local market.[27/] Such anti-competitive tactics are easier to carry out when a distributor (a large MSO, for example) also owns an important programming source.[28/] In addition, as the MSO becomes larger, the more credible become its threats to disadvantage the program vendor at the distribution level if it refuses to cooperate with the distributor's programming tactics. Such a disadvantage could be produced, for example, by placing the vendor's program on a high channel, where it is less likely to be viewed by subscribers, or by refusing to carry the service. Other tactics could include overpricing a particular program or not including it in the optimal tier.

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[26/] See T.G. Krattenmaker and S.C. Salop, "Anti-competitive Exclusion: Rising rivals' costs to achieve power over price," 96 Yale L. J. 209-295, (1982); and J.A. Ordover et al., "Non-price anti-competitive behavior by dominant firms toward the producers of complementary products," in F. Fisher (ed.), Antitrust and Regulation, MIT Press (1985).

[27/] See, "Cable Television v. The Alternatives: A Study in Antitrust," prepared by the Office of Congressman Charles E. Schumer (Sept. 14, 1987), for an argument that incumbent MSOs have prevented entry of new cable distribution technologies.

[28/] D.T. Scheffman and P.T. Spiller, "Buyers and Entry Barriers," Federal Trade Commission, Bureau of Economics Working Paper No. 154, August 1987.

Another business strategy of CSOs is, in effect, the sale of channel placement to programmers by means of obtaining from program vendors a discount from the price in exchange for preferential placement. Because broadcast television stations cannot sell their programming to cable at any market-related price, they do not have at present an efficient mechanism for competing with other programmers for valuable channel assignments.

To the extent that the FCC may be correct that independents actually compete for viewers and advertising revenue with cable systems,[29] the decisions to move these stations to higher channels should at the very least raise some concern. This is because the need to ensure that the pursuit of legitimate business objectives -- which includes maximization of profits from distribution of programming -- by cable systems should not undermine the public policy objective of securing a wide range of programming choices for cable subscribers and other television audiences. On the other hand, to the extent that broadcast television programming is valuable to cable systems, perhaps it should be placed on equal footing with other programming products in its ability to compete for valuable channel location. This is especially important for the local stations that are no longer protected by must-carry rules and for whom exclusion or suboptimal channel placement could amount to a financial death sentence.

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[29] National cable advertising revenues, although small in proportion to those of broadcast networks, have been increasing rapidly. Revenues were $546 million, $735 million and $930 million from 1984 through 1986 respectively. Estimates for 1987 advertising revenues are $1.142 billion, a 10 percent increase over 1986.

It is not our view that regulation of the MSOs' programming decisions is necessarily a desirable public policy. It is our opinion, however, that in light of the structural changes in the cable industry, such programming decisions can assume consequences which did not previously exist. To the extent that they do, they raise serious public policy concerns.

### 3. The FCC Has Paid Insufficient Attention to Alternate Delivery Technologies

It seems clear that aside from direct head on competition from another wired cable system -- as it exists in overbuilds --- the most plausible constraint on the market power of local cable franchises should come from alternative delivery technologies such as MMDS or wireless cable, SMATV, and DBS.[30/] The available evidence suggests that these alternative cable technologies have not yet made significant inroads into the "video marketplace." The troublesome possibility, however, as recent developments in the cable industry strongly suggest, is that entry impediments have increased rather than decreased in the post-deregulation marketplace.

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[30/] Direct competition from cable systems owned and operated by fiber-optics-using telephone companies has yet to materialize. Its future is mired in complex legal and regulatory battles.

Interestingly, the FCC has expressed little interest in facilitating entry of these technologies. Indeed, having found that broadcast television offers an effective constraint on cable in many local franchises, the Commission paid mere lip service to alternative technologies which allegedly are inferior from the engineering standpoint to standard cable. The Commission's stance however, confuses economic benefits with engineering assessments. From the social standpoint, the relevant benefits from those alternative technologies have to be related to the associated costs. For example, the fact that some of these technologies can offer fewer channels of programming than state-of-the-art cable systems is not enough to dismiss them from the marketplace. In many respects, these technologies entail fewer sunk costs, are less expensive to install, and are cheaper to maintain than are standard cable systems. In addition, their presence in the marketplace would afford additional competition to incumbent CSOs which could inure to the benefit of cable subscribers.

### 4. The Effect of The 1984 Cable Act on The Cable Industry: Who Has Benefitted?

It is too early to render a definitive judgment on the social benefits engendered by the FCC's implementation of the effective competition provisions of the 1984 Cable Act. However, the available data indicate that so far the only unambiguous beneficiaries of the Act have been the owners of cable systems. The advantages for consumers are unclear, at best.

The owners of cable systems plainly have benefitted through increased prices paid by buyers for the existing cable systems. Cable system owners have also benefited from the ability to raise basic subscription rates without interference from regulatory authorities. Subscribers have suffered as a result of these price increases, at least to the extent that these price increases exceed the benefits from additional programming that the operators are now increasingly including in the basic tier.31/

Tables 4 and 4a show the history of average monthly basic cable rate increases since 1979.32/ During the period 1979-1985, the average rate increase granted to operators requesting rate increases was between 13.6 percent and 17.8 percent (with an average increase of 15.3 percent over the period) above the old rates. In 1986, the average basic cable rate had increased 20 percent above the old rates for those operators that had increased their basic rates. For the first half of 1987, cable operators, no longer subject to rate regulation, have increased their basic cable rates by approximately 24 percent. In a 1986 survey of 282

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31/ A recently released study by National Cable Television Association (NCTA) shows that from December 1986 to June 1987, basic subscribers in a surveyed sample received an additional 1.6 channels in their basic package, going from 27.3 to 28.9 channels. "Rate Deregulation: Cable Industry Pricing Changes and Service Expansion in a Deregulated Environment," NCTA, Washington, D.C. (November 1987).

32/ The data are estimates of Paul Kagan Associates as reported in their publications, Cable TV Franchising and the Kagan Census.

cable operators, the Cable Television Administration and Marketing Society found that 75 percent of those surveyed planned rate increases ranging from relatively low increases to more substantial increases (30 percent). On average, the expected increase would be 18.5 percent.[33]

In a more recent survey conducted by the National League of Cities of 233 franchising authorities covering 274 franchises serving 4.68 million subscribers, it was found that 82.6 percent of the cable operators surveyed increased their basic rates. In 40.4 percent of the rate increases, the number of services included in basic services also increased. In the other 42.3 percent where the number of services was not increased, the average increase of basic rates was 27.5 percent. Of the 42.3 percent that did not increase the number of services, however, 17.3 percent decreased their pay service rates. Of the remaining cable operators surveyed, 14.4 percent did not change their basic service rates while only 2 percent reduced their rates.[34] Even a recently released study of the deregulated cable industry by National Cable Television Association found that, in a sample of 598 responding cable systems[35] which reach

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[33] This is reported by Laura Landro, "Cable TV's New Freedom Promises Higher Prices - but More Services," Wall Street Journal, p. 31, C4, Dec. 12, 1986.

[34] National League of Cities, Impact of the Cable Act on Franchising Authorities and Consumers, Washington, D.C., September 18, 1987.

[35] The overall response rate was 23%. There is no evidence one way or the other whether the responding cable systems were significantly different from those which

16% of cable households, the average basic rate increased by 10.6% since January 1987. NCTA's estimates appear to be very low in comparison with those reported by other sources.

Table 4 also compares annual industry average basic cable rates to the average rate increases for those systems granted increases in the same year. (See also Figures 1-3). During the period 1979-86, rate increases for the average system obtaining a rate increase were approximately 3 percent to 5 percent higher than the industry average. In 1985, the average system that obtained a rate increase was almost equal to the industry average. While 1987 figures are not yet available, it seems likely that the rate increases for those operators raising their rates will be higher than the industry average as the number of rate changes has also increased significantly. In 1986, for example, there were rate changes in 566 communities in 40 states. In contrast there have already been 968 rate changes in 45 states in the first half of 1987.[36]

Accompanying the relative price changes, a survey by the National League of Cities also shows that there was a reduction in the number of basic service tiers in 1987. Approximately 17 percent of the MSOs surveyed reduced their basic service tiers; 80.8 percent offered no change; and only 2.3 percent actually increased the number of basic service

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failed to respond to the questionnaire.

[36] Estimates of Paul Kagan Associates, Cable TV Franchising News Roundup, September 31, 1987, p. 2.

tiers. Prior to deregulation, 57.7 percent of the cable operators offered only one basic service tier; 25.7 offered 2 tiers; 11.3 percent offered 3 tiers; and 5.4 percent offered 4 or more tiers. After deregulation, 71.2 percent offered one basic tier; 18.1 percent offered two tiers; 6.2 percent offered 3 tiers and 4 percent offered 4 or more tiers.

Thus, the available evidence strongly points to increased basic rates in the deregulated marketplace. In addition, as Paul Kagan observes, CSOs pushed through substantial rate increases in anticipation of full deregulation in January of 1987. As stated in The Pay TV Newsletter, "[w]ith anticipation of full deregulation in January 1987, cable operators took the lid off basic rates in 1985. According to KAGAN CENSUS data, operators hiked basic rates by a record 11%...."[37/] And, as we noted in Table 4, substantial rate increases took place in 1986. Indeed, over the past two and a half years, basic rates increased by about a third, substantially in excess of increases in the CPI.

It is important to note that it is not possible to use the surveyed data on prices to test whether the FCC's "three signal" rule for estimating effective competition is valid. First, neither the National League of Cities nor the NCTA relates price changes in particular franchises to the number of available broadcast television signals, which is the key issue here. Second, the NCTA study neglects the fact

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[37/] The Pay TV Newsletter, Paul Kagan Associates, May 30, 1986, p.4.

that basic rates increased rapidly during 1985 and 1986. Third, the studies do not indicate whether the basic rates in the regulated environment were substantially below monopoly levels. Indeed, if these rates were close to monopoly levels, deregulation would not have a significant impact on basic rates. Nevertheless, the fact that rates have been increasing rapidly suggests that some previously unexploited pricing power is now available to CSOs.

## 5. The FCC Can And Should Do Better Analysis Than That Which Resulted in The "Three Signals" Finding

This synopsis suggests that the short history of the deregulation of cable is far from a picture of unambiguously procompetitive behavior. Deregulation was not required to bring financial health to a sickly business, as it did for the railroad industry for example. In fact, prior to deregulation cable companies were in sound financial positions (especially if they were able to renege on promises made during franchise bidding wars). Also, deregulation did not bring lower prices to a mass of cable subscribers, as it did in the airline industry.[38] In fact, subscription prices appear to have risen substantially even after making allowance for expansion of programming included in basic service. And, finally, deregulation did not induce the entry of new competitors as it did in the airline industry. In fact, the alternative cable technologies are finding the deregulated environment largely inhospitable to entry and expansion. Under these circumstances, as implemented by the FCC, the 1984 Cable Act may have been unwise legislation. In any event, the radical changes in the marketplace to which the Act has contributed demonstrate that the Commission's conclusions about competition for cable are, at a minimum, based on out-of-date information and poor methodology.

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[38] See, e.g., S. Morrison & C. Winston, "The Economic Effects of Airline Deregulation," The Brookings Institution (Washington, DC), 1986.

Table 1
U.S. Cable Penetration
(1985-1987)

| | Total Systems | Percent Increase | Basic Subscribers | Percent Increase | Pay Units | Percent Increase | Homes Passed | Percent Increase | Total Franchised Homes | Percent Increase |
|---|---|---|---|---|---|---|---|---|---|---|
| 1985 | 6675 | | 30759556 | | 25599448 | | | | | |
| 1986 | 7546 | 0.13 | 36931375 | 0.20 | 27042372 | 0.06 | 52171078 | | 47023634 | |
| 1987* | 7836 | 0.04 | 38762246 | 0.05 | 28637268 | 0.06 | 55477512 | 0.06 | 49890122 | 0.06 |

* As of April 1, 1987

Source: Television and Cable Factbook, 1985, 1986 and 1987 Editions.

Table 2

Pay Cable Packager--Cable System Operator Ties
(1978-79 Data)

| Corporate Owner | Pay Cable Packager | Number of Affiliates | Subscribers | Cable MSO | Number of Systems | Subscribers |
|---|---|---|---|---|---|---|
| Time, Inc. | Home Box Office | 800 | 2,000,000 | ATC[1] | 94 | 714,000 |
| (Joint Venture) | Showtime | 260 | 650,000 | Teleprompter | 110 | 1,110,000 |
| | | | | Viacom | 30 | 360,000 |
| Warner | Star Channel | 17 | 105,000 | Warner | 140 | 576,000 |
| | | ---- | -------- | | --- | ------- |
| TOTALS | | 1077 | 2,755,000 | | 374 | 2,760,000 |
| % OF NATIONAL TOTALS[2] | | | 84% | | | 19% |

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Source: Braunstein (1980)

Notes:

[1] Does not include Manhattan Cable (94,000 subscribers)

[2] Based on 14,500,000 cable subscribers and 3,300,000 pay subscribers

## Appendix A1

| Rate Increase (Percentage) | Cost/Price Ratio | | | | | |
|---|---|---|---|---|---|---|
| | 1/1.5 | 1/2 | 1/3 | 1/4 | 1/10 | 1/20 |
| 1 | 3 | 2 | 1.5 | 1.3 | 1.1 | 1.1 |
| 10 | 30 | 20 | 15.0 | 13.3 | 11.1 | 10.5 |
| 25 | 75 | 50 | 37.5 | 33.3 | 27.8 | 26.3 |
| 50 | 150 | 100 | 75.0 | 66.7 | 55.6 | 52.6 |
| 75 | 225 | 150 | 112.5 | 100.0 | 83.3 | 78.9 |
| 100 | 300 | 200 | 150.0 | 133.3 | 111.1 | 105.3 |

To read this table, the first column represents various rate increases. Reading horizontally for each respective rate increase are the percent reductions in market penetration required to make the rate increase unprofitable. For example, a 10 percent rate increase would be unprofitable if it were to induce a 20 percent reduction in market penetration with a cost/price ratio equal to 1/2. (20 = (10/[1 - (1/2)]) = (10/[1 - (vc/p)]).

Table 3

Pay Cable Packager--Cable System Operator Ties
(1984 Data)

| Corporate Owner | Pay Cable Packager | Number of Affiliates | Subscribers | Cable MSO | Number of Systems | Subscribers |
|---|---|---|---|---|---|---|
| Time, Inc. | Home Box Office | 5,000 | 12,500,000 | ATC | 463 | 2,400,000 |
| (Joint Venture)[1] | Showtime/ | 3,100 | 5,000,000 | Viacom | 19 | 752,000 |
| | The Movie Channel | 2,900 | 3,000,000 | Warner Amex | n/a | 1,383,000 |
| TOTALS | | 11,000 | 20,500,000 | | | 4,535,000 |
| % OF NATIONAL TOTALS[2] | | | 100% | | | 15% |

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**Sources:** Broadcasting Cablecasting Yearbook and Television & Cable Factbook

**Notes:**

[1] Owners of combined Showtime/The Movie Channel joint venture:

| | |
|---|---|
| Viacom | 50% |
| Warner Amex | 31% |
| Warner Communications | 19% |

(one of the owners of Warner-Amex).

[2] Based on 30,000,000 cable subscribers and 20,000,000 pay subscribers.

TABLE 4

| Year | (1) Average Old Rate | (2) Average Rate Increase Granted* | (3) Average Percent Increase (By Year) [(2)-(1)]/(1) | (4) Rate of Increase of Basic Rates | (5) Industry Average Basic Rate | (6) Industry Percent Increase (By Year) [(5)-(1)]/(1) | (7) Rate of Increase Industry Rates | (8) Percentage of Difference [(2)-(5)]/(5) |
|---|---|---|---|---|---|---|---|---|
| 1979 | 6.75 | 7.76 | 14.96 | -- | 7.53 | 11.56 | -- | 3.05 |
| 1980 | 7.03 | 8.08 | 14.94 | 4.12 | 7.85 | 11.66 | 4.25 | 2.93 |
| 1981 | 7.32 | 8.36 | 14.21 | 3.47 | 8.14 | 11.20 | 3.69 | 2.70 |
| 1982 | 7.70 | 8.88 | 15.32 | 6.22 | 8.46 | 9.87 | 3.93 | 4.96 |
| 1983 | 7.92 | 9.22 | 16.41 | 3.83 | 8.76 | 10.61 | 3.55 | 5.25 |
| 1984 | 8.31 | 9.79 | 17.81 | 6.18 | 9.20 | 10.71 | 5.02 | 6.41 |
| 1985 | 9.00 | 10.23 | 13.67 | 4.49 | 10.24 | 13.78 | 11.30 | -0.10 |
| 1986 | 9.51 | 11.41 | 19.98 | 11.53 | 11.08 | 16.51 | 8.20 | 2.98 |
| 1987 ** | 10.26 | 12.70 | 23.78 | 11.31 | N/A | N/A | N/A | N/A |

* For 1979 through 1986, rate/system increases granted by local authorities. In 1987, basic rate increases were deregulated.

** First six months of 1987 only.

(1) Rate/system.
(2) Includes tiers.
(5) Rate/subscriber.

Source: Paul Kagan Associates, Cable TV Franchising, various issues.

Notes to accompany Table 4:

The table compares annual average basic cable rates (rate/subscriber) to the average rate increases for cable systems that were granted rate increases (rate/system) in the same year.

Columns 1-4 summarize data for just those cable systems that were granted rate increases. Column 1 shows the average basic rate prior to the rate increases; Column 2 shows the average rate increase that were granted for 1979-1986. Column 3 shows the percentage increase in basic rates in any year for those systems that had rate increases granted. Column 4 calculates the percentage change of the average rate increase granted by local authorities over time.

Column 5 shows the annual average basic cable rate (rate/subscriber) for the period 1979-1986. Column 6 shows the percentage increase of annual average cable rates for each year calculated using the average old rate as the standard of comparison. This calculation will differ slightly from that in Column 3 since it calculates the average basic rate of all cable systems (i.e. including those which did not have rate increases granted and those which had not applied for a rate increase in any particular year). Column 7 shows the increase of the annual average basic rate over time.

Column 8 shows the difference between the average rate increase granted to cable systems (Column 3) and the annual average basic rate (Column 6). It shows that, between 1979 and 1986, the average cable system that was granted a rate increase charged approximately 3 - 5 percent more than the industry average.

TABLE 4A

| Year | (1) Average Old Rate | (2) Average Rate Increase Granted* | (3) Average Percent Increase (By Year) [(2)-(1)]/(1) | (4) Rate of Increase of Basic Rates | (5) Industry Average Basic Rate | (6) Industry Percent Increase (By Year) [(5)-(1)]/(1) | (7) Rate of Increase Industry Rates | (8) Percentage of Difference [(2)-(5)]/(5) |
|---|---|---|---|---|---|---|---|---|
| 1986 | 9.51 | 11.41 | 19.98 | 11.53 | 11.08 | 16.51 | 8.20 | 2.98 |
| 1987(i) ** | 10.26 | 12.70 | 23.78 | 11.31 | 12.70 | 23.78 | 14.62 | 0.00 |
| 1987(ii) ** | 10.26 | 12.70 | 23.78 | 11.31 | 12.27 | 19.59 | 10.74 | 3.50 |
| 1987(iii)** | 10.26 | 12.70 | 23.78 | 11.31 | 12.10 | 17.89 | 9.16 | 5.00 |

1987(i) Estimated 1987 industry average equal to average rate increase.
1987(ii) Estimated 1987 industry average 3.5 percent less than the average rate increase.
1987(iii) Estimated 1987 industry average 5.0 percent less than the average rate increase.

* For 1979 through 1986, rate/system increases granted by local authorities. In 1987, basic rate increases were deregulated.
** First six months of 1987 only.

(1) Rate/system.
(2) Includes tiers.
(5) Rate/subscriber.

Source: Paul Kagan Associates, Cable TV Franchising, various issues.

Table 4A uses the data in Table 4 to calculate estimates of the annual industry average basic cable rate in 1987. Using the average rate increase of those cable systems that had increased their basic rates in the first six months of 1987 as a benchmark, we calculate three estimates of the average basic rate for 1987. The different estimates depend upon assumptions of how much the annual average basic rate will differ from the average rate increase for those cable systems that increased their rates. Since this difference averaged between 3 and 5 percent throughout the period 1979-1986, the first estimate is made on the assumption that the annual basic rate will be the same as the average rate increase of those systems that raised their rates; the second is that the annual average rate will be less than the average rate increase by 3.5 percent; and the third is that the annual average rate will be less than the average rate increase by 5 percent. These estimates seem reasonable in light of the increasing number of rate increases that have already taken place in 1987. In 1986, for example, there were rate changes in 566 communities in 40 states and the average cable system that was granted a rate increase charged roughly 3 percent more than the industry average basic rate. In contrast, there were 968 rate changes in 45 states in the first half of 1987.[1] Therefore, the larger percentage of all cable systems increasing their rates would tend to make the average rate increase by cable systems that have raised their rates closer to the industry average in 1987.

In a recent survey of cable rate deregulation by the National Cable Television Association (NCTA),[2] the average basic service rate that an average subscriber paid in July 1987 was found to be $13.11. The NCTA study shows that the rate increase for the cable systems surveyed had increased by 10.6 percent between December 1986 and July 1987. Using their estimate of the average basic rate in July 1987, the increase of the industry annual average basic rate over that which prevailed in 1986 would then be 18.3 percent (significantly higher than our relatively conservative estimates). In contrast, in 1985-1986 the industry annual average basic rate had increased by only 8.2 percent.

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[1] Estimates of Paul Kagan Associates, Cable TV Franchising News Roundup, September 31, 1987, p.2.

[2] National Cable Television Association, Rate Deregulation: Cable Industry Pricing Changes and Service Expansion in a Deregulated Environment, November 1987.

Figure 1: Average Rate Increases Granted
Versus Changes in the
Consumer Price Index (CPI)
By Year (1979-1987)

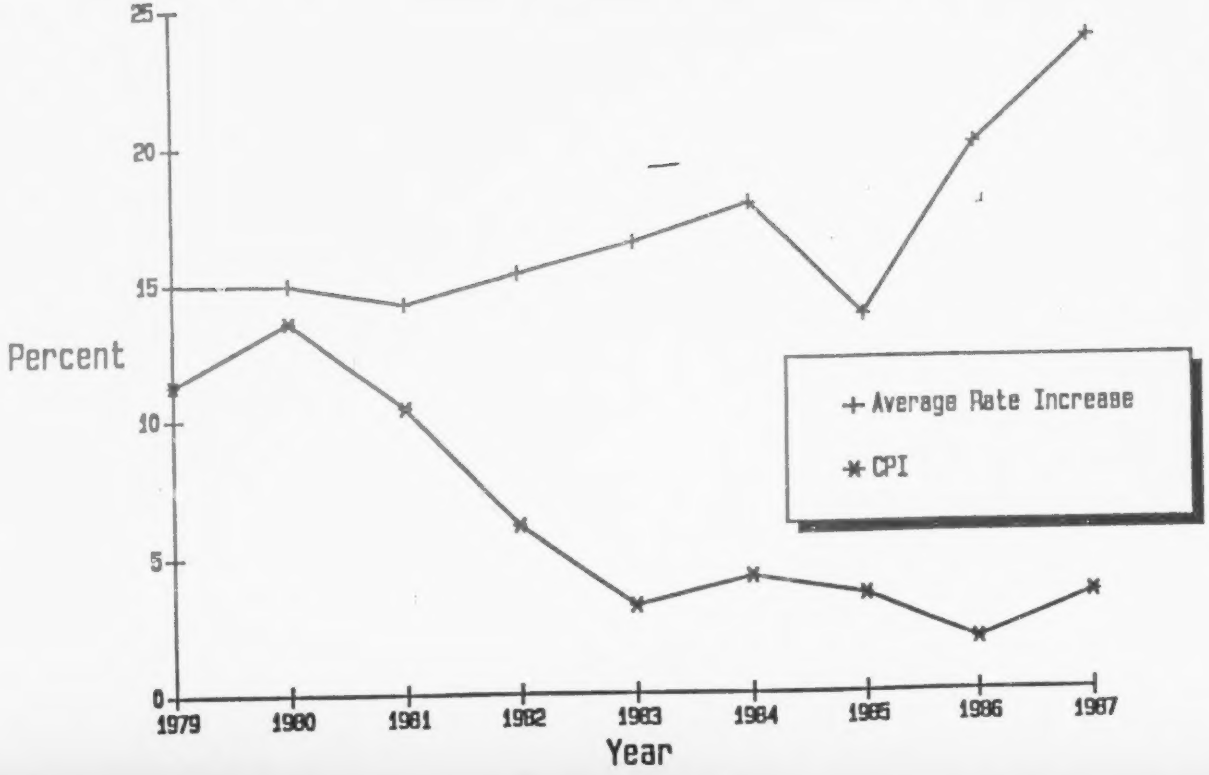


Figure 2: Industry Average Rates/Subscriber
(1979-1987)

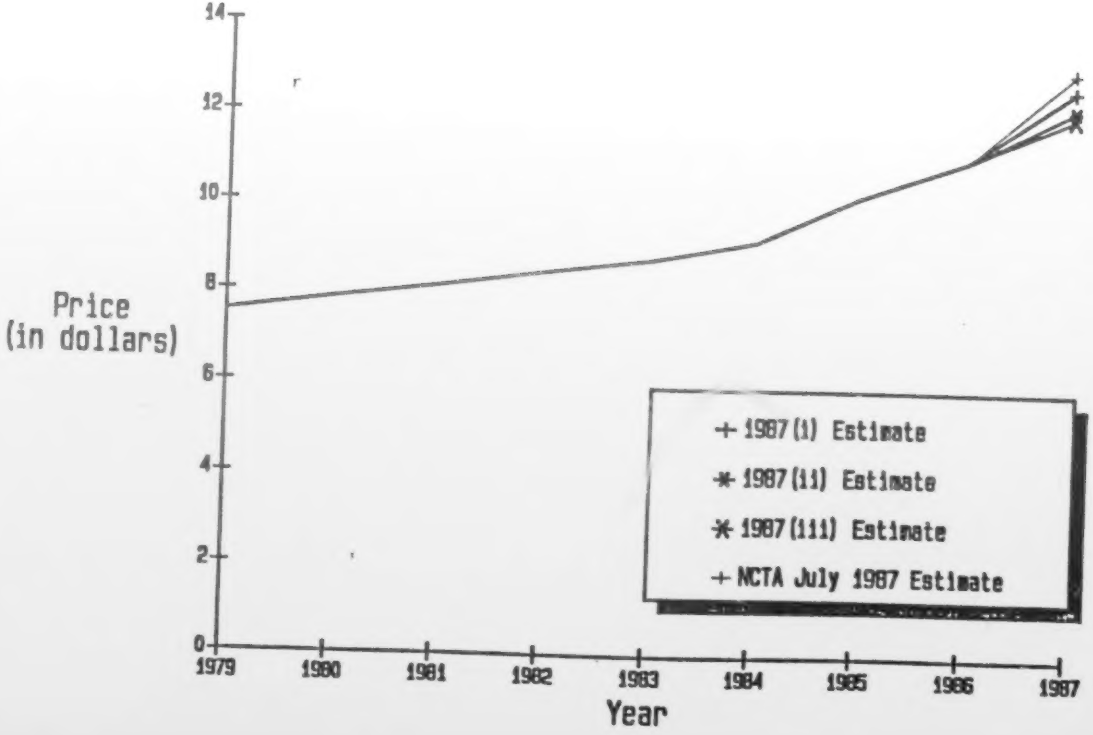
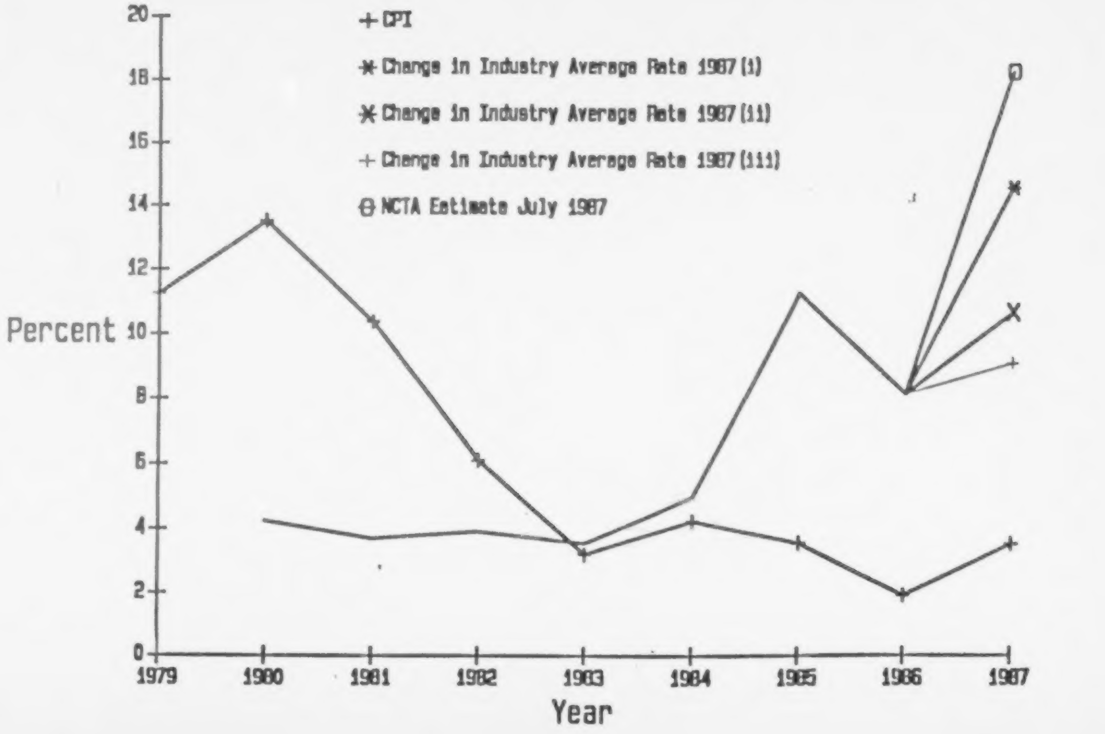


Figure 3: Percentage Increase of the Industry Average Basic Rate Using Different Estimates of the 1987 Industry Average (1979-1987)



Attachment No. 2

# CARDOZO ARTS & ENTERTAINMENT LAW JOURNAL

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## ANTITRUST AND REGULATION IN CABLE TELEVISION: FEDERAL POLICY AT WAR WITH ITSELF

By
GLENN B. MANISHIN

# ANTITRUST AND REGULATION IN CABLE TELEVISION: FEDERAL POLICY AT WAR WITH ITSELF

Glenn B. Manishin[*]

## I. Introduction

Although antitrust law and regulation often conflict,[1] one situation in which the two should presumably function in harmony is natural monopoly.[2] Where a single firm can most efficiently supply all the demand in a given market, antitrust has often given way, in large part, to regulation.[3] Electric utilities, for example, are generally considered natural monopolies, and as a consequence, are both protected against competitive entry and subject to universal service obligations.[4] While the antitrust laws certainly apply to efforts to extend natural monopoly power,[5] antitrust and regulation have achieved a workable equilibrium; one firm serves the entire market and its rates are constrained by regulation, typically by prescribing the firm's prices or rate of return.[6] In short, the traditional *quid pro quo* for the *market failure* of natural monopoly is regulation.[7]

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[1] *See, e.g.*, MCI Communications Corp. v. AT&T, 708 F.2d 1081, 1100-11 (7th Cir.) (discussion of cases regarding the conflict of antitrust law and regulation), *cert. denied*, 464 U.S. 891 (1983); United States v. AT&T, 461 F. Supp. 1314, 1321 (D.D.C. 1978); 1 P. Areeda & D. Turner, Antitrust Law ¶ 223d (1978); Comment, *The Application of Antitrust Law to Telecommunications*, 69 Calif. L. Rev. 497 (1981).

[2] Natural monopoly can be defined in nontechnical terms as a market "characterized by . . . high economics of scale . . . such that a single firm will be the most efficient supplier of goods or services in the long run at any given level of demand." *Report on Regulatory Reform by the Industrial Regulation Committee of the American Bar Assocation Section of Antitrust Law*, 54 Antitrust L.J. 503, 506, 516 (1985) [hereinafter *Regulatory Reform Report*]. The economic definition of natural monopoly is considerably more complicated. *See, e.g.*, Baumol, *On the Proper Cost Tests for Natural Monopoly in a Multiproduct Industry*, 67 Am. Econ. Rev. 809, 809-10 (1977). The typical assumption is that "in a market conducive to natural monopoly, . . . only a single firm can survive." *Regulatory Reform Report*, *supra*, at 506; *see also* Fishman v. Estate of Wirtz, 807 F.2d 520, 532 (7th Cir. 1986) (professional basketball in any major city is a natural monopoly since only one team can practically survive).

[3] "In [natural monopoly] markets, traditional utility-type rate regulation is imposed to maintain prices and output at levels that are supposed to approximate the results of effective competition." *Regulatory Reform Report*, *supra* note 2, at 506.

[4] The electric power industry is regulated at both the state and federal levels. *See* 16 U.S.C. § 824 (1982). Other industries in which the natural monopoly rationale have served to justify public utility regulation include railroads, oil and gas pipelines, and telephone service. *Regulatory Reform Report*, *supra* note 2, at 506; *see generally* S. Breyer, Regulation and its Reform 15-35 (1982). As in other industries, the precise boundaries of the natural monopoly in the electric power industry have been the subject of dispute. *See, e.g.*, City of Cleveland v. Cleveland Elec. Illuminating Co., 538 F. Supp. 1306 (N.D. Ohio 1980).

In cable television, however, harmony has yet to be achieved. Developments over the past several years have established a legal environment in which cable television is largely subject to neither antitrust nor regulation. First, in implementation of the Cable Communications Policy Act of 1984 ("Cable Act"),[8] the Federal Communications Commission ("FCC") determined that virtually all cable television systems face "effective competition," precluding municipal rate regulation.[9] Second, in aspects such as system design and channel deployment, the Cable Act preempts the major means of nonrate cable regulation through restrictions on enforcement of franchise terms.[10] Finally, after spending nearly two years examining both the phenomena of cable system "clustering"[11] and mergers between "overbuilds",[12] the Department of Justice (the "Department") announced in April 1985 that it will defer to municipalities on cable mergers and generally refuse to apply the Clayton Act[13] in light of cable's "natural monopoly characteristics."[14]

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[5] *E.g.*, Otter Tail Power Co. v. United States, 410 U.S. 366 (1973); City of Mishawaka v. American Elec. Power Co., 616 F.2d 976 (7th Cir. 1980). *cert. denied*, 449 U.S. 1096 (1981).

[6] *See supra* note 3. The natural monopoly justification for regulation can be used strategically by firms and legislatures to promote their own interests; it may be used to shelter a firm from competition and permit subsidized rates for some classes of consumers. R. Noll & B. Owen, The Political Economy of Deregulation 53-65 (1983).

[7] Some have argued that an unregulated natural monopoly is preferable to an inefficiently regulated natural monopoly. *See* Kahn, *The Passing of the Public Utility Concept: A Reprise*, *in* Telecommunications Regulation Today and Tomorrow 3-37 (E. Noam ed. 1983); Posner, *Natural Monopoly and its Regulation*, 21 Stan. L. Rev. 548 (1969). Still others have argued that "contestable" natural monopoly markets will behave competitively. *See* Panzar & Willig, *Free Entry and the Sustainability of Natural Monopoly*, 8 Bell J. Econ. 1 (1977). However, the traditional public utility model generally remains valid.

[8] Pub. L. No. 98-549, 98 Stat. 2780 (codified as amended at 47 U.S.C. §§ 521-59 (Supp. III 1985)).

[9] *See infra* text accompanying note 66-69. Section 623(b)(1) of the Cable Act, 47 U.S.C. § 543(b)(1) (Supp. III 1985), directed the FCC to promulgate, within 180 days, "regulations which authorize a franchising authority to regulate rates for the provision of basic cable service in circumstances in which a cable system is not subject to effective competition." The rules ultimately adopted by the FCC prohibit municipal rate regulation for more than 99% of all cable systems. Brief for Intervenors National League of Cities at 13, ACLU v. FCC, 823 F.2d 1554 (D.C. Cir. 1987) (No. 84-1666) [hereinafter National League of Cities Intervenor's Brief].

[10] For example, section 624(b) of the Cable Act, 47 U.S.C. § 544(b)(2)(b) (Supp. III 1985), provides that municipalities may seek and enforce programming requirements only for "broad categories of video programming." This provision prevents enforcement of franchise terms that commit the cable system to carry specified programming services. Similarly, section 625(a)(1), 47 U.S.C. § 545(a)(1) (Supp. III 1985), provides that cable systems can modify extant franchise agreements if: (a) provisions relating to facilities or equipment are "commercially impracticable" or (b) with regard to programming services, the "mix, quality, and level" of service is maintained. Section 625(b), 47 U.S.C. § 545(b) (Supp. III 1985), grants a right to judicial review of denied requests for franchise modification, and section 625(c), 47 U.S.C. § 545 (c) (Supp. III 1985) allows a cable system to drop programming services if the copyright payment is "substantially" increased and "has not been specifically compensated for" by rate increases. Finally,

Although the FCC and the Department have often disagreed,[15] their positions regarding cable are incompatible. The FCC has apparently concluded that cable systems generally *are not* natural monopolies, and therefore should not be regulated. If so, then antitrust laws should be enforced vigorously to preserve both actual and potential competition in cable television, particularly to prevent mergers among overbuilt systems. However, the Department will not challenge these mergers[16] because it concludes that cable systems generally *are* natural monopolies.

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Section 626, 47 U.S.C. § 546 (Supp. III 1985), provides procedural rules for municipal consideration of franchise renewals, and requires franchises to be renewed if, *inter alia*, the cable system has "substantially complied with the material terms" of the franchise and its "quality" of service has been "reasonable in light of community needs." Section 626(e), 47 U.S.C. § 546(e) (Supp. III 1985), also grants a right to judicial review for cable systems of refranchising decisions.

The Cable Act's legislative history clearly indicates that the purpose of these sections was to provide "stability *and certainty* to the renewal process," H.R. REP. No. 934, 98th Cong., 2d Sess. 25 (1984) (emphasis added) [hereinafter HOUSE REPORT]. The Act in effect creates a presumption of franchise renewal. The actual impact of these provisions, however, has yet to be tested significantly in the market. While there are indications that refranchising competition may increase over time, *see id.* at 22; *Rights Wars Growing in Cable TV*, Wall St. J., Aug. 25, 1982, at 21, col. 2, there is no clear trend. *See infra* text accompanying notes 115-16.

[11] "Clustering" is the consolidation of cable systems in adjoining or nearby municipalities. *See* Note, *Product Market Definition For Video Programming*, 86 COLUM. L. REV. 1210, 1217 (1986).

[12] "Overbuild" is the term used in the cable television industry to describe situations in which two or more competing cable systems serve all or part of the same geographic area. Nishimura v. Dolan, 599 F. Supp. 484, 489 n.4 (E.D.N.Y. 1984).

[13] 15 U.S.C. § 12 (1982). Section 7 of the Clayton Act prohibits mergers and acquisitions "against unlawful restraints and monopolies" in any market. *Id.* at § 7.

[14] *See infra* text accompanying notes 72-73.

[15] *See, e.g.*, United States v. AT&T, 552 F. Supp. 131, 170, 187 (D.D.C. 1982), *aff'd sub nom.* Maryland v. United States, 460 U.S. 1001 (1983). The Department of Justice's [hereinafter Department] 1986 support of proposed legislation introducted by Senator Dole, *see* S. 2565, 99th Cong., 2d Sess. (1986), that would have transferred jurisdiction of the *AT&T* decree to the FCC, *see, e.g.*, Remarks by Douglas H. Ginsburg, Assistant Attorney General, Antitrust Division, before the Computer and Communications Industry Association (July 17, 1986), appeared designed, at least in part, to mend the rift between the agencies arising from the *AT&T* litigation. *See also* Report and Recommendations of the United States Concerning the Line of Business Restrictions Imposed on the Bell Operating Companies by the Modification of Final Judgment, United States v. Western Elec. Co., No. 82-0192 (D.D.C. filed Feb. 2, 1987) (recommending major modifications to the *AT&T* decree and increased reliance on FCC regulation).

[16] Nor has the Department indicated any real willingness to address other current competitive issues in cable television. *See infra* notes 79, 103, 120-24, 132-34 and accompanying texts.

As a result, current federal policy effectively applies neither regulation nor antitrust to cable television.

The conflict between the FCC and the Justice Department is perhaps the clearest example of the present disarray in cable television policy, but it is not the only one. The Supreme Court has recently entered the fray, under the guise of the first amendment, suggesting that cable competition can be *mandated* under certain circumstances by the Constitution.[17] A number of federal courts have applied the antitrust laws to cable mergers and cable franchising competition.[18] While the Department has decided to defer to municipal competitive decisions on cable, the Federal Trade Commission has threatened to sue municipalities for restricting competition in industries such as taxi cabs.[19]

The issue whether cable is a natural monopoly is the subject of debate among economists,[20] but it is somewhat less relevant than the issue of who should make that determination, i.e., whether the FCC, the Department, the federal courts, states, or municipalities should set competitive and regulatory policy in cable televsion. Another issue concerns whether competitive structure of local cable markets should be decided by the market itself. Indeed, if municipalities can determine the number of cable firms that can serve a market, thereby "preempting" the Department's antitrust enforcement role, arguably they should also determine the degree of regulation appropriate to that market, in effect preempting the FCC. The answers to these questions may not be easy. If they remain unresolved, however, the internal tensions in federal cable policy may spark something few observers want: a new round of lobbying on Capitol Hill and, perhaps, a new legislative solution that satifies no one.[21]

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[17] *See* City of Los Angeles v. Preferred Communications, Inc., 476 U.S. 488 (1986); *see infra* text accompanying notes 104-14. For a discussion of this case along similar lines, *see* Comment, *Do Cable Operators Want Free Speech or a Free Market? Preferred Communications, Inc. v. City of Los Angeles*, 6 CARDOZO ARTS & ENT. L.J. 161 (1987).

[18] *See infra* notes 96-101 and accompanying text.

[19] *See In re* City of New Orleans, 3 Trade Reg. Rep. (CCH) ¶ 22,149, at 22,997-98 (May 10, 1984).

[20] *See, e.g.*, B. OWEN & P. GREENHALGH, COMPETITIVE POLICY CONSIDERATIONS IN CABLE TELEVISION FRANCHISING (1985); A. SMILEY, DIRECT COMPETITION AMONG CABLE TELEVISION SYSTEMS (1986); Noam, *Economies of Scale in Cable Television: A Multiproduct Analysis*, *in* VIDEO MEDIA COMPETITION: REGULATION, ECONOMICS AND TECHNOLOGY (E. Noam ed. 1985); *see also* Nadel, *Cablespeech for Whom?*, 4 CARDOZO ARTS & ENT. L.J. 51, 62 n.62 (1984) (fewer than 50 cable system overbuilds in existence); "Range Wars", *Cable Television Business*, Sept. 15, 1985, at 21-24 (discussing cable overbuilds).

[21] During the first session of the 99th Congress, Senator Danforth, then Chairman of the Commerce Committee, reportedly suggested that "Congress might be forced to redress some imbalance" in the rules governing must-carry, franchise exclusivity, cable system concentration, and other matters. COMMUNICATIONS DAILY, Aug. 1, 1986, at 3.

## II. A Tale of Two Agencies

The FCC's approach to cable television has evolved considerably over the years. In the industry's early history, the FCC imposed a number of restrictive regulations upon cable systems.[22] These regulations were premised on the fear that cable's widespread growth could threaten the economic viability of broadcast television, and correspondingly, the FCC's long-standing broadcast policy favoring localism.[23] With the collapse of this rationale, however, the FCC was forced to reconsider its protectionist approach. Subsequent changes included: preemption of municipal rate regulation of "pay" cable programming;[24] repeal of the syndicated exclusivity and distant signal rules;[25] and finally, preemption of restrictions on the "retiering" of system channel deployment.[26]

The FCC's evolving regulatory approach to cable television roughly corresponded to the evolution of the cable industry itself. Cable began as community antenna television (or CATV)—

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[22] These restrictive regulations included: limitations on cable carriage of broadcast television signals; guaranteed exclusivity for syndicated programming carried by local independent broadcast stations; mandated nonduplication by cable systems of broadcast network affiliates; and restrictions on cable system channel capacity. *See generally* S. Rivkin, Cable Television: A Guide to Federal Regulations (1974). The FCC's policies "[i]n combination . . . effectively halted the growth of cable television in major markets." 1 C. Ferris, F. Lloyd, & T. Casey, Cable Television Law ¶ 5.05, at 5-12 (1987).

[23] *See generally*, Note, *The Collapse of Consensus: Effects of the Deregulation of Cable Television*, 81 Colum. L. Rev. 612, 615-17 (1981).

[24] Clarification of Cable Television Rules, Notice of Proposed Rule Making and Inquiry, 46 F.C.C.2d 175, para. 84 (1974); Establishment of Cable Television Subscriber Rates, Notice of Inquiry, 58 F.C.C.2d 915, para. 2 (1976). "Pay" cable services, which do not carry advertising and frequently offer movies, charge a monthly fee for service in addition to the rate charged for the standard package of "basic" cable channels. Home Box Office, a service of Time, Inc., was the first commercially successful pay cable service. *See infra* text accompanying notes 28-33.

[25] Cable Television Syndicated Program Exclusivity Rules, 79 F.C.C.2d 663 (1980), *aff'd sub nom.* Malrite T.V. of N.Y. v. FCC, 652 F.2d 1140 (2d Cir. 1981), *cert. denied*, 454 U.S. 1143 (1982). These rules required cable systems to "black out" syndicated programming if a local independent broadcast station, carried by the cable system, had an exclusive contractual right to that programming, and limited the number of nonlocal broadcast stations cable systems could carry. *Cf.* Geller v. FCC, 610 F.2d 973 (D.C. Cir. 1979) (per curiam). The FCC recently proposed that the syndicated exclusivity rule be reimposed, suggesting that it is anticompetitive and may give cable an unfair advantage over broadcast television. 3 FCC Rule Making Rep. (CCH) ¶ 21,045 (1987).

[26] Community Cable TV, Inc., Memorandum Opinion and Order, 95 F.C.C.2d 1204, paras. 18, 21-22 (1983), *reconsideration*, 98 F.C.C.2d 1180, paras. 13, 19, 23 (1984). This FCC decision permitted cable systems to move programming services among different "tiers," *e.g.*, from the basic tier to an intermediate "expanded" tier for which an additional monthly fee is charged, regardless of any contrary provisions of municipal franchises. For a discussion of tiering, *see* 2 C. Ferris, F. Lloyd & T. Casey, *supra* note 22, ¶ 17B.03[1][c][i], at 17B-20-21. Although many cable systems provide various tiers of basic cable service, pay services are generally not available unless the consumer also subscribes to a basic service. *See* Friedman v. Adams Russell Cable Services-N.Y., Inc., 624 F. Supp. 1195 (S.D.N.Y. 1986).

a rudimentary means of collecting broadcast television signals for retransmission in areas where over-the-air reception was negligible or poor.[27] The introduction of Home Box Office,[28] however, ushered in an era during which a host of new satellite-delivered programming services were developed specifically for distribution over cable.[29] These services initially consisted exclusively of studio-produced movies airing before network television first-run exhibition, but later expanded to include the well-known, advertiser-supported "basic"[30] cable services such as ESPN, CNN, and MTV,[31] frequently limited to a single subject and providing round-the-clock programming, and "superstations"[32] such as Atlanta's WTBS.[33] As a result, by the late 1970's, cable system size had increased geometrically, sometimes to 100 channels or more, and competition for cable franchise awards created substantial incentives for even larger systems with increasingly elaborate "bells and whistles."[34] With a seemingly inexhaustible supply of programming, favorable tax treatment,[35] and extraordinarily high cash flow, the industry's future appeared virtually unlimited.[36]

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[27] 1 C. Ferris, F. Lloyd & T. Casey, *supra* note 22, ¶ 5.03 n.6, at 5-5.

[28] *See supra* note 24.

[29] *See, e.g.*, Home Box Office, Inc. v. FCC, 567 F.2d 9 (D.C. Cir.) (per curiam) (vacating "anti-siphoning" rule for pay cable), *cert. denied*, 434 U.S. 829 (1977).

[30] *See supra* note 26. Section 602(2) of the Cable Act defines basic cable service as "any service tier which includes the transmission of local television broadcast signals." 47 U.S.C. § 522(2) (Supp. III 1985). *See* House Report, *supra* note 10, at 40. As noted below, the FCC's redefinition of basic cable service was reversed on appeal by the D.C. Circuit. *See infra* note 51.

[31] ESPN is the Entertainment and Sports Programming Network, now owned by ABC. CNN is the Cable News Network, a service of Turner Broadcasting Systems. MTV is Music Television, a music video programming service, owned by Viacom.

[32] Superstations are broadcast television stations distributed to cable systems nationwide by satellite. *See* 2 C. Ferris, F. Lloyd & T. Casey, *supra* note 22, ¶ 17B.02[3][c], at 17B-10.

[33] More than forty satellite-delivered cable television programming services are available nationwide. *See* Quincy Cable TV, Inc. v. FCC, 768 F.2d 1434, 1452 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 2889 (1986); Scrambling of Satellite Television Signals, Report and Order, 104 F.C.C.2d 1444, 1448-49 (1986).

[34] This colloquial term of art in the cable industry denotes "extra" features, such as sophisticated local origination facilities and two-way data transmission capability, that many cable television companies offered to municipalities to induce the award of a franchise. Extremely heated franchising competition among cable companies, and a number of instances in which cable systems could not supply all of the "bells and whistles" required by their franchising commitments, were the principal reasons cited by Congress to support restricting municipal authority to seek (or enforce) certain types of franchise obligations. *See* House Report, *supra* note 10, at 21-22.

[35] *See* 1 C. Ferris, F. Lloyd & T. Casey, *supra* note 22, ¶ 29.01, at 29-2. Until it was eliminated in 1987, the investment tax credit provided cable systems with generous federal tax deductions for the capital costs of system construction. In addition, many cable systems, even among the largest cable companies, are organized as limited partnerships, with the attendant tax advantages associated with that form of ownership.

[36] The balance may now have swung too far in the other direction: favoring cable at

In contrast to the FCC, throughout the 1970's, the Department viewed cable television with almost benign neglect. Although the Department participated in a number of FCC rulemakings, its antitrust enforcement efforts in television focused largely on a series of monopolization lawsuits against the three broadcast networks.[37] As the decade came to a close, however, the Department began to take a more active antitrust interest in the cable industry. In 1980, the Department successfully challenged the formation by a number of leading movie studios of "Premiere," a new movie-driven pay cable service with exclusive first-refusal rights to the studios' output.[38]

The Department's enforcement activity in cable television shifted shortly thereafter from cable programmers to system operators. Beginning in mid-1983, the Department initiated a series of antitrust investigations, covering a half dozen transactions over the course of nearly two years,[39] into the competitive effect of cable system acquisitions, mergers and "swaps."[40] Initially concerned primarily with the phenomenon of clustering and its effects on franchising competition, these investigations were later expanded to include mergers among overbuilt systems[41] and, eventually, well-publicized transactions between several of the

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the expense of other media. One FCC Commissioner has criticized the "disequilibrium" resulting from federal policies which "may give cable television an unwarranted competitive edge in the program delivery market . . . [and have] helped to create the potential for cable to 'bottleneck' reception of off-air and satellite programming." Amendment of Part 76 of the Commission's Rule Concerning Carriage of Television Broadcast Signals by Cable Television Systems, 1 F.C.C. REC. 864, 915 (1986) (statement of Commissioner Dawson).

[37] *E.g.*, United States v. National Broadcasting Co., 449 F. Supp. 1127 (C.D. Cal. 1978) (entering consent decree).

[38] United States v. Columbia Pictures Indus., Inc., 507 F. Supp. 412 (S.D.N.Y. 1980), *aff'd*, 7 Media L. Rep. (BNA) 1342 (2d Cir. 1981). The Premier venture was disbanded following the issuance of a preliminary injunction. Three years later, similar antitrust problems arose in the merger of Showtime and The Movie Channel, two leading pay cable programmers. Under threat of a Department lawsuit, the merger was restructured to eliminate several movie studios as participants in the post-merger venture. *See, e.g.*, 2 C. FERRIS, F. LLOYD & T. CASEY, *supra* note 22, ¶ 24.09[3][c], at 25-27; N.Y. Times, Aug. 13, 1983, § 1, at 29, col. 1; N.Y. Times, July 19, 1983, § D5, col. 5.

[39] In October 1985, James Mooney, then President of the National Cable Television Association, described the Department's "rather consistent interest" in cable system transactions, but observed that the "Justice [Department] is not warming up its paddy wagon to come get us." *Mooney Issues Warning on Antitrust Issues*, Multichannel News, Oct. 21, 1985, at 11, col. 3.

[40] These transactions, which are often structured as like-kind exchanges for tax purposes, involve the exchange of cable systems among cable television companies. The transaction involving Phoenix, Arizona discussed throughout this Article is one example of such a swap. *See infra* text accompanying notes 70-73.

[41] Two of the Department's 1984 investigations focused on mergers between directly competing systems in Slidell, Louisiana and Bryan/College Station, Texas. *See* Multichannel News, Apr. 15, 1985, at 4, col. 1.

largest multiple system operators ("MSOs").[42]

The Department's antitrust policy toward cable television was still in the formative stage when the prospect of cable legislation arose in Congress.[43] Commencing with Senate Bill No. 66, the initial bill introduced by Senator Goldwater,[44] the Department opposed restricting the scope of municipal regulatory authority over cable on the ground that this could undermine the effectiveness of franchise competition. The Department reasoned that in the absence of direct competition between cable systems, competition for the franchise itself served as a surrogate for the competitive discipline of the market.[45] The concerted lobbying of the cable industry, however, coupled with the intuitive appeal of a handful of instances of overreaching by municipalities in the franchising process, were apparently persuasive. The Administration did not advance the Department's objections to Senate Bill No. 66 and, in fact, took no public position on the bill.[46]

In the summer of 1984, a negotiated compromise between the National Cable Television Association ("NCTA") and the National League of Cities[47] revived the legislation, which had stalled in the Senate, and returned the focus in cable television to the FCC. The Cable Act, passed initially in the House and barely amended in conference, eliminated Senate Bill No. 66's standard for rate deregulation of cable systems: the existence of four broadcast stations serving the community.[48] The Cable Act instead delegated the issue to the FCC, directing the FCC to determine in what circumstances rate regulation is appropriate.[49] Existing franchise provisions permitting rate regulation would be grandfathered until January 1, 1987, after which regulation would be authorized where "a cable system is not subject to effective competition" pursuant to Commission-promulgated rules.[50]

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[42] Mulitple System Operator ("MSO") is a cable industry term denoting a company that operates more than one cable television system. For the past five years or more, the two largest MSOs have been Tele-Communications, Inc. ("TCI"), and American Television & Communications Corp. ("ATC"), a subsidiary of Time, Inc.

[43] Although the Department investigated a number of cable television system mergers and acquisitions in 1983 and 1984, *see Closed Circuit: Hounds Loose*, BROADCASTING, July 9, 1984, at 9, each of these was either approved by the Department or voluntarily withdrawn by the parties.

[44] S. 66, 98th Cong., 1st Sess. (1983). *See also* S. 2172, 97th Cong., 2d Sess. (1982); 129 CONG. REC. S325-26 (daily ed. Jan. 26, 1983) (statement of Sen. Goldwater); 128 CONG. REC. 3358-61 (1982).

[45] The Department's reasoning on this point was hardly unconventional. *See, e.g.*, Posner, *supra* note 7, at 562 (emphasizing ability of municipalities "to drive a hard bargain with the would-be monopolist").

[46] The Department's objections were forwarded to the Office of Management & Budget as part of the established process of review by executive branch agencies of proposed legislation and bills passed by Congress. The Administration did not explain publicly why it declined to take a position in support of or in opposition to S. 66.

[47] *See* 130 CONG. REC. H10,435, H10,440, H10,442 (daily ed. Oct. 1, 1984); 130 CONG. REC. S14,284 (daily ed. Oct. 11, 1984).

[48] *See* S. 66, 98th Cong., 1st Sess. § 607 (1983); S. REP. NO. 67, 98th Cong., 1st Sess. 22-23 (1983).

The "effective competition" debate before the FCC was acrimonious. Yet it hinged less on considerations of appropriate regulatory policy and more on the antitrust-oriented issue of product market definition.[51] Beginning from the somewhat tenuous premise that the Act was intended to deregulate most cable systems,[52] the FCC proposed that where four nonduplicated broadcast signals are available, the "subscriber's ability to disconnect" provides effective competition for cable television.[53] The cable industry supported this proposal in full measure, contending that a host of alternative distribution media—including videocassette recorders ("VCRs"), subscription television ("STV"),[54] satellite master antenna television ("SMATV"),[55] multipoint and multichannel multipoint distribution services ("MDS" and "MMDS"),[56] direct broadcast satellite ("DBS"),[57] low-power television ("LPTV"),[58] and satellite or "television receive-only" earth stations ("TVROs")[59]—had developed to present effective competition for the delivery of video programming by cable systems.[60] The industry maintained that cable existed within a far broader market and did not enjoy monopoly power.[61]

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[49] Cable Act § 623, 47 U.S.C. § 543 (Supp. III 1985); *see* House Report, *supra* note 10, at 24-25, 65-68; *supra* note 9.

[50] Cable Act § 623(b), (c), 47 U.S.C. § 543(b), (c) (Supp. III 1985).

[51] Two issues of statutory interpretation—the scope of "basic cable service" for which the Cable Act authorized regulation (*see* Cable Act § 602(2), 47 U.S.C. § 522(2) (Supp. III 1985)) and the validity of the FCC's decision preempting restrictions on retiering (*see* Community Cable TV, Inc., 98 F.C.C.2d 1180 (1984)) were also the subject of considerable debate. For a discussion of the Commission's redefinition of "basic cable service," see ACLU v. FCC, 823 F.2d 1554, 1565-70 (D.C. Cir. 1987). *Compare* House Report, *supra* note 10, at 40, *with* National League of Cities Intervenor's Brief, *supra* note 9, at 35-36. With regard to retiering, see Cable Act § 625(d), 47 U.S.C. § 545(d) (Supp. III 1985) (the House Report defines "basic cable service" as "any service tier" while the FCC in *Community Cable* restricts "basic service" to a single tier of service); House Report, *supra* note 10, at 24; 130 Cong. Rec. S14,286 (daily ed. Oct. 11, 1984) (Act does not affect legal challenge to FCC's 1984 retiering decision).

[52] *See* Implementation of the Cable Communications Act of 1984, 50 Fed. Reg. 18,637, 18,650 n.69 (1985) (to be codified at 47 C.F.R. pts. 1, 63, 76 & 78) (Congress intended "to significantly deregulate the provision of cable service"); Hearings Before the Subcommittee on Communications of the Committee on Commerce, Science and Transportation United States Senate, 97th Cong., 2d Sess. 193 (1982) (statement of Mark Fowler, FCC Chairman) ("presumption that the marketplace environment in which cable television operates is competitive").

[53] Implementing the Provisions of the Cable Communications Policy Act of 1984 in MM Docket No. 84-1296, FCC 84-612, Notice of Proposed Rulemaking, 49 Fed. Reg. 48,765, 48,771 (1984) (to be codified at 47 C.F.R. pts. 1, 63 & 76).

[54] STV is a broadcast service generally using UHF frequencies to distribute pay television programming. *See* Subscription Television, Inc. v. Southern Cal. Theatre Owners Ass'n, 576 F.2d 230 (9th Cir. 1978). One example of STV is Oak Industries' "ON-TV," which at one time was a popular service in Southern California. The STV industry has suffered a serious decline in recent years, however, since it is "unable to compete with the multichannel programming diversity cable provides." 2 C. Ferris, F. Lloyd & T. Casey, *supra* note 22, ¶ 18.05, at 18-9.

[55] SMATV is essentially a private cable system serving apartment complexes and other multiple dwelling units. *See* D. Brenner & M. Price, Cable Television § 13.01

Despite Congress' admonition that the existence of alternative distribution media nationwide was an insufficient basis on which to presume that a cable television system is subject to effective competition in any specific market,[62] few industry mem-

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(1986). SMATV is a good example of a technology that on the surface appears to be a substitute for cable television, but in reality is not competitive in many markets. Some respected commentators believe that there is a large potential market for SMATV which "will assure that cable does not hold a monopoly." 2 C. Ferris, F. Lloyd & T. Casey, *supra* note 22, ¶ 19.10 at 19-19. Yet the 1982 National Association of Broadcasters study (*id.* ¶ 21.02 n.1, at 21-3), clearly states that SMATV offers only a "selective" threat and is "somewhat threatening to franchised cable *in markets where it becomes available before cable became entrenched.*" H. Howard & S. Carroll, SMATV, Strategic Opportunities in Private Cable 179 (1982) (emphasis added). *See also infra* note 130 (cable programmers have refused to deal with SMATV systems).

[56] MDS is a point-to-multipoint microwave technology, frequently used to distribute pay television services in areas such as Washington, D.C., that are not served by a cable television system. *See* D. Brenner & M. Price, *supra* note 55, § 16.04[1][a] to [3][a]. MMDS is a multichannel MDS service, authorized by the FCC pursuant to lottery, that has yet to be introduced commercially in most major markets. *Id.* § 16.04[4][b].

[57] DBS is a satellite service that involves the transmission of TV signals from the earth to high-powered stationary satellites that permit reception by equipped individual homes. *See* National Ass'n of Broadcasters v. FCC, 740 F.2d 1190, 1195 (D.C. Cir. 1984). DBS is not yet in commercial operation. *See id.*

[58] LPTV is a newly authorized UHF broadcast service using transmitters of lower power than those traditionally required for UHF stations.

[59] TVROs are the formal name for home earth stations, and are known colloquially as satellite "dishes" or home satellite dishes ("HSDs"). *See* Scrambling of Satellite TV Signals, Notice of Inquiry, 104 F.C.C.2d 1444 (1986).

[60] These comments and arguments are summarized in the FCC's decision. *See infra* note 67.

[61] Some parties absurdly stretched this position. *See, e.g.*, Comments of Farrow, Schildhause at 3, MM Docket No. 84-1296 (F.C.C. filed Jan. 29, 1985) (cable competes in a market that includes "movie houses, newspapers, radio stations, colleges and universities, legitimate theatres, mail and express services, telephones, stadiums, local opera societies and sports teams, houses of religious worship and more"). Even more restrained members of the industry, however, continue to maintain that "the relevant product market necessarily includes not only video programming delivered by means other than cable [television], such as broadcast television, MDS, SMATV and VCRs, but also other sources of news, information and entertainment which themselves compete with video sources." Reply Memorandum of the Time Defendants at 5 n.5, New York Citizens Comm. on Cable TV v. Manhattan Cable TV, Inc., 651 F. Supp. 802 (S.D.N.Y. 1986).

[62] House Report, *supra* note 10, at 25, 66 (The Commission's standards "should apply on a community-by-community basis since the presence nationwide of various telecommunications services does not speak to the availability of such services in a particular community. The Committee thus does not intend that [the Commission should] impose nationwide deregulation, as it has attempted to do in other rulemakings."). *Id.* at 66.

bers offered more than a broad-brush approach to the issue. The Department, for its part, proposed a set of far more restrictive criteria. The Department argued that the "alphabet soup" of alternative delivery technologies had failed to develop as predicted by the cable industry and were effectively confined to relatively small niches in most markets.[63] According to the Department, the economics of broadband cable television systems, specifically the ability to deliver a large number of programming channels at a relatively low cost per subscriber, coupled with the growing array of satellite-delivered cable programming available from few, if any, alternative delivery technologies, often resulted in cable systems enjoying significant market power.[64] In short, the Department had concluded that cable television is a distinct product market.[65]

Not surprisingly, the Department's proposal attracted heated opposition from the cable industry. In April 1985, both the proposal and its underlying analysis were summarily dismissed by the FCC.[66] Relaxing its proposed standard, the FCC concluded that "alternative sources of video programming . . . do, in fact, offer competition to cable services"[67] and that "a cable system will be considered to face effective competition whenever the franchise market receives three or more unduplicated broadcast signals."[68] While not expressly ground in antitrust analysis, the Commission's position is clear: cable television competes within a broad "video programming" market and is generally not a monopoly, much less a natural one.[69]

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[63] "In the present technological and economic setting the likelihood of successful future entry by alternative media simply is too speculative to effectively constrain the present pricing behavior of cable operators." Reply Comments of the U.S. Dept. of Justice at 13, MM Docket No. 84-1296 (F.C.C. filed Feb. 11, 1985). For an extensive discussion of the limits to which the "alphabet soup" of alternative delivery technologies has made competitive inroads on cable television, see *The New Order Passeth*, BROADCASTING, Dec. 10, 1984, at 43; see also Noam, *Local Distribution Monopolies in Cable Television and Telephone Service: The Scope for Competition*, in *Telecommunications Regulation Today and Tomorrow* 351, 359 (E. Noam ed. 1983) ("a closer look at each of these ostensible competitors reveals that cable's significant technological and economic advantages will probably make it the dominant medium of the future, barring unforeseen technological or regulatory developments"). *Cf.* Quincy Cable TV, Inc. v. FCC, 768 F.2d 1434, 1439 n.8, 1450 (D.C. Cir. 1985) (noting "cable's virtually unlimited channel capacity"), *cert. denied*, 106 S. Ct. 2889 (1986).

[64] *See* Comments of the U.S. Dept. of Justice at 3, 5, MM Docket No. 84-1296 (F.C.C. filed Jan. 28, 1985) [hereinafter DOJ Comments].

[65] *See id.* at 23 n.43 ("cable systems are likely to be able to exercise significantly greater power over price than is required under the [Department's] Merger Guidelines to conclude that a group of products or services constitute a relevant market"); *id.* at 16 n.26 ("the distinctive competitive characteristics of cable television is the ability to deliver a relatively large number of video channels in a given market at a relatively low cost per channel"). According to Charles F. Rule, then Acting Assistant Attorney General for Antitrust, the Department considers cable television to be a relevant product market and the franchise area to be a relevant geographic market for antitrust purposes. Freeman, *Justice Adopts Hands-Off Stand on Clustering Systems*, Multichannel News, Apr. 15, 1985, at 4, col. 3 [hereinafter *Hands-Off Clustering*].

[66] Amendment of Parts 1, 63 and 76 of the Commission's Rules to Implement the Provisions of the Cable Communications Policy Act of 1984, 50 Fed. Reg. 18,637, 18,649-50 (1985), *reconsideration*, 104 F.C.C.2d 386 (1986), *aff'd in part, rev'd and remanded in part*, ACLU v. FCC, 823 F.2d 1554 (D.C. Cir. 1987).

[67] 50 Fed. Reg. at 18,649.

While the "effective competition" rulemaking was pending before the FCC, the Justice Department's antitrust investigations continued. The Department intensively reviewed (for more than eight months) a proposed transaction which was, at that time, one of the largest cable system mergers on record; the "swap" between two major MSOs of cable systems in eight markets valued at approximately $200 million, including the two directly competing, overbuilt systems in Phoenix, Arizona and a nearby suburb.[70] In light of the prominence of the Phoenix overbuilds,[71] it was widely assumed that the Department's decision on the Phoenix transaction would crystallize its antitrust enforcement policy for cable television.

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[68] 50 Fed. Reg. at 18,650.

[69] In affirming the FCC's three-station rule for cable deregulation, the D.C. Circuit did not review the underlying competitive and economic findings asserted by the Commission, stressing rather, "the relatively short time frame within which Congress directed the agency to complete its rulemaking [and that it] fully anticipate[s] that the Commission will carefully monitor the effects of its regulations and make adjustments where circumstances so require." *ACLU*, 823 F.2d at 1565. Indeed, as several parties pointed out, the FCC's belief that a cable system does not gain "significant market advantage" by offering satellite-delivered non-broadcast programming services, 50 Fed. Reg. at 18,650, was "squarely contradicted by the record, which demonstrate[d] that the cable industry experienced explosive growth only after offering these various non-broadcast services." Brief for Intervenors National League of Cities, *supra* note 9, at 25. Moreover, the Commission's exclusive focus on "local broadcast television [does] not reflect the economic realities of basic cable service, [specifically] the fact that 'basic cable service' is marketed and priced as a package that frequently includes far more than must-carry and local access channels." DOJ Comments, *supra* note 64, at 29. As the D.C. Circuit has recognized in a related context, "[c]able television and ordinary commercial broadcast television operate on the basis of wholly different technical and entrepreneurial principles." *Quincy Cable TV*, 768 F.2d at 1438.

[70] *See Times Mirror, Storer Trade Eight Systems in Largest Swap Ever*, Multichannel News, July 9, 1984, at 1, col. 1. The transaction involved nearly 200,000 subscribers and arose in the first instance because the firms "ha[d] been locked in a competitive overbuild situation" in Paradise Valley, Arizona, an affluent Phoenix suburb. *Id.* at 34.

[71] As the chief cable officer for Phoenix stated in 1984, " 'if you want to test competition, this is the best place to do it,' [since there are] three companies [that] operate in the city, and about 10% of Phoenix households can receive service from either Times Mirror or Storer." *Phoenix May Deregulate Rates & Basic Service*, Multichannel News, Apr. 23, 1984, at 21, col. 4. In Phoenix, the award of a multiple franchise followed the failure of the incumbent franchisee to build out its system and was in turn followed by one of the most rapid construction schedules of any major American city. Other overbuilds have followed this pattern. *See, e.g.*, Nishimura v. Dolan, 599 F. Supp. 484, 488-489 (E.D.N.Y. 1984) (Huntington, New York). There are also indications that, in light of rate deregulation, overbuilds will increasingly be encouraged by cities as a means of constraining cable television rates. *See Cable Industry Faces Increased Threat of Overbuilds*, Multichannel News, Sept. 21, 1987, at 20, col. 1; *Patrick Warns Cablers to Steer Clear of Battle with Cities on Overbuilds*, COMMUNICATIONS DAILY, May 21, 1987, at 2; *FL Utility Unit Begins Cable System Overbuilds*, Multichannel News, Aug. 4, 1986, at 1, 35, col. 1; *NYT Exec*

Unknown to most, however, the Department became increasingly concerned with the relationship between the roles of municipal and federal government in cable system transactions and the federalism implications of antitrust enforcement decisions. In April 1985, just two weeks before the FCC adopted its final "effective competition" rules, the Department terminated its investigation into the Phoenix transaction. In an unusual step, the Department issued a press release announcing that it would generally decline to challenge consolidation of competing systems in light of cable's "natural monopoly characteristics" and, instead, would defer to the decisions of muncipalities as franchisors.[72] As the Department's press release explained:

> [W]here the relevant local government has the authority to deny transfer of a cable television franchise and thereby to prevent consolidation of overbuilt franchises, the Department will generally rely on the municipality's decision and will not bring suit to prevent consolidation unless unusual facts indicate that an exception should be made.
>
> A single firm may be able to provide cable service at lower cost than two or more competing firms. . . . However, cable operators may not necessarily be forced by competitive pressures to return to consumers the benefit of efficiencies that result from consolidation and, in addition, a combination of overbuilt franchises can, at least in the short run, result in higher prices to consumers.
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> The local government responsible for a cable franchise decision usually is in the best position to evaluate the preferences of their citizens in the face of these potentially conflicting economic effects.[73]

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*Sees Overbuilds in Areas with Classic Systems*, Multichannel News, Mar. 3, 1986, at 29, col. 1; *San Diego Proceeding with Overbuild Strategy*, Cablevision, July 8, 1985, at 11-12. *See also* Communications Daily, Feb. 2, 1987, at 13 (if cable industry continues to prevail on first amendment grounds against municipal franchising authorities, "it could alienate cities to the point that they would grant franchise overbuilds").

[72] Department of Justice Press Release (April 1, 1985) [hereinafter DOJ Press Release]. *See* 2 C. Ferris, F. Lloyd & T. Casey, *supra* note 22, ¶ 24.06[4], at 24-20.1; Communications Daily, April 2, 1985, at 2. *See also Hands-Off Clustering*, *supra* note 65, at 4 (interview of then Acting Assistant Attorney General for Antitrust, Charles F. Rule). The Department conceded that, because of "the extent of the overbuild," the transaction would "eliminate substantial competition" in Paradise Valley. DOJ Press Release at 2.

[73] DOJ Press Release, *supra* note 72, at 2-3 (statement of J. Paul McGrath, Assistant Attorney General, Antitrust Division).

## III. The Policy Conundrum

The degree to which actual and potential competition exists among cable systems in any given market, or between cable and alternative video delivery technologies, is a complex issue necessitating a detailed examination of market-specific evidence. Regardless of one's conclusion as to the existence and economic feasibility of competition, however, it is clear that the competitive policies articulated by the FCC, the Department, and the Congress are almost entirely inconsistent. On the fundamental policy of the role of municipalities in the regulatory process, each approaches the issue from contradictory premises.

The FCC's prophylactic three-station standard for "effective competition," sacrificing accuracy in favor of adminstrative simplicity,[74] leaves no room either for countervailing market-specific evidence or municipal discretion. Coupled with the FCC's prior rulings preempting state and local authority over pay cable rates and cable system tiering,[75] the standard suggests that the FCC believes local government is essentially incompetent to make the economic judgments on which to predicate regulatory decisions or, if given such authority, would likely opt for parochial solutions restricting cable's development. Whether such an approach can weather the Supreme Court's recent retrenchment of the FCC's power to preempt state regulation[76] is unclear. What is evident is that the FCC places little faith in municipalities as policy makers.

The Department has articulated precisely the opposite conclusion. It will decline to prosecute an otherwise meritorious action against a merger of cable systems under the Clayton Act if the municipalities involved approve the necessary franchise transfers.[77] In the Department's view, not only are municipalities competent to make economic judgments on cable's regulatory and competitive treatment, but since local government "is in the best position to evaluate the preferences of their citizens,"[78] such judgments should be given preclusive effect. Indeed, the Department has seemingly abandoned all antitrust activity with regard to cable mergers since approving the Phoenix "swap" and apparently will even decline to review cable transactions absent some affirmative invitation by the affected municipalities.[79] While the welfare effects of cable system consolidation may be ambiguous in the Department's view, the practical consequences of its deferral policy are clear. Federal antitrust enforcement has been effectively jettisoned.

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[74] The FCC's similar decision to discontinue deciding cable franchise fee disputes, arising before enactment of the Cable Act, was reversed. Yakima Valley Cablevision, Inc. v. FCC, 794 F.2d 737 (D.C. Cir. 1986). The FCC's decision in the "effective competition" rulemaking was affirmed in part and reversed in part. ACLU v. FCC, 823 F.2d 1554 (D.C. Cir. 1987).

[75] *See supra* notes 24, 26 and accompanying texts.

[76] *Compare* Louisiana Pub. Serv. Comm'n v. FCC, 106 S. Ct. 1890 (1986) (state regulation of depreciation rates was not preempted by FCC regulations) *with* Capital Cities Cable v. Crisp, 467 U.S. 2694 (1984) (state regulation of retransmission by cable television system was preempted).

[77] Ironically, the Commission has reemphasized that it will not review cable system mergers and acquisitions under the antitrust laws, but rather will defer to the antitrust enforcement decisions of the Justice Department. Group W Cable, Inc., ¶¶ 18-19, Mimeo No. 4808 (released May 27, 1986) (acquisition of Group W by TCI, ATC, and other MSOs). *Accord* Policy Regarding Character Qualifications in Broadcast Licensing

Congress has appeared to steer a middle course, confirming municipal competence to set regulatory policy while limiting the breadth of its discretion. In the franchising area, for example, the Cable Act provides that while cities may establish a prior franchising requirement, some substantive franchise provisions are unenforceable.[80] The Act also places significant procedural restrictions on the ability of municipalities to refuse franchise renewals and grants a right to judicial review.[81] In the area of rate regulation, Congress similarly provided that municipalities have the competence to regulate rates, but reserved to the federal government the power to define when that authority may be exercised.[82]

On the merits, there are a number of substantial policy issues arising from the fact that despite whatever natural monopoly characteristics they enjoy, "cable operators may not necessarily

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in Docket No. FCC 85-648, 102 F.C.C.2d 1179, at para. 44 (1986); Teleprompter Corp., Memorandum Opinion and Order, 87 F.C.C.2d 531, para. 21 (1981).

[78] DOJ Press Release, *supra* note 72, at 3.

[79] Senator Metzenbaum, Chairman of the Antitrust Subcommittee of the Senate Committee on the Judiciary, has indicated an interest in examining the issue of cable industry concentration and the Department's merger policies in cable television. *See* COMMUNICATIONS DAILY, Feb. 23, 1987, at 7.

[80] *See supra* note 10 (discussion of franchising restrictions). Section 621(a) of the Cable Act, 47 U.S.C. § 541(a) (Supp. III 1985), allows municipalities to grant "1 or more" franchises. Although Congress suggested that the Act's franchising provisions permit municipalities to determine "the number of cable operators to be authorized to provide service in a particular geographic area," HOUSE REPORT, *supra* note 10, at 59, Congress specifically did not intend to revise the antitrust laws. *Id.* Indeed, the Ninth Circuit has stated that these provisions violate the first amendment. Preferred Communications, Inc. v. City of Los Angeles, 754 F.2d 1396, 1411 n.11 (9th Cir. 1985), *aff'd*, 476 U.S. 488 (1986).

[81] *See supra* note 10.

[82] Cable Act § 623, 47 U.S.C. § 543 (Supp. III 1985). In light of the "growing" number of consumer complaints regarding cable rate increases after rate deregulation became effective on January 1, 1987, there have been suggestions that Congress may step in and revise this balance. *See Markey Warns Cable to Exercise New Rights Cautiously*, COMMUNICATIONS DAILY, Feb. 25, 1987, at 3.

be forced by competitive pressures to return to consumers the benefit of efficiencies that result from consolidation."[83] It may not be correct to assume, for example, that regulatory and antitrust enforcement policy in cable should follow the traditional model for natural monopoly. Even if cable television is a natural monopoly in *every* market, it could plausibly be argued that cable is nevertheless sufficiently different from such essential services as electricity, gas, and local telephone service that treatment as a utility is unwarranted. Similarly, while cable's natural monopoly characteristics may give cable systems market power in a significant number of markets, regulation involves costs and burdens different from, and often greater than, antitrust enforcement. It may therefore be justifiable to tolerate a greater degree of market power before imposing regulation than before using the antitrust laws to restrict mergers and acquisitions among cable systems.[84]

The problem, though, is that these subtle policy issues have only rarely been raised and have never been decided. The fallout of the FCC's virtually complete deregulation of cable rates, coupled with the Department's antitrust policy of nonenforcement, is that cable is treated like a utility for antitrust purposes but treated as a competitive industry for regulatory purposes. Ironically, therefore, while a city can determine that a single cable firm will best serve its citizens, it is stripped of the ability to limit the welfare loss arising from monopoly pricing. While a city can, according to the Department, create or sanction a monopoly in cable television, it cannot, according to the FCC, regulate that monopoly. This policy conundrum means that neither federal nor local government has discretion to apply a compromise between the competitive and public utility models to cable television.

From a federalism perspective as well, the FCC and the Department are acting at cross-purposes. If municipalities are in the best position to determine the structure of local cable markets, they should also be in the best position to determine the level of regulation appropriate to that market. In other words, if the federal government is going to defer to municipalities on cable antitrust issues, it should similarly defer on cable regulatory issues. In terms of municipal authority to protect the health, safety, and welfare of consumers, if a city decides its police power justifies limiting cable to a single firm, for example, to avoid pole attachment problems or the repeated inconvenience of underground cable construction, there is little apparent justification for precluding the city from regulating the firm to whom it awards the franchise.

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[83] DOJ Press Release, *supra* note 72, at 3.

[84] *See* DOJ Comments, *supra* note 64, at 15 n.25.

Since the Department has already applied its laissez-faire policy toward cable system consolidation for more than two years, it is unlikely that its current leadership will reconsider that policy in light of the FCC's preemption of municipal ratemaking authority. However, there are a number of compelling reasons for reconsideration. First, under the "state action" exemption to the antitrust laws,[85] municipalities may grant an exclusive franchise, or deny a franchise to a potentially competing system, only if state law has clearly articulated and affirmatively expressed a policy of displacing competition.[86] Municipalities enjoy no inherent right to create a monopoly in any industry.[87] The Department's deferral rule, however, applies regardless of applicability of the state action exemption. This approach effectively produces a balkanization of the antitrust laws,[88] with their applicability to cable acquisitions depending fortuitously on the localities involved in any specific transaction.

Second, the Department's approach is clearly inconsistent with its enforcement policies in most other industries. For example, the Department can (and sometimes has) approved mergers and joint operating agreements between newspapers in the same city despite the opposition of municipal governments. In other instances in which anticompetitive effects are localized, such as price-fixing among retailers and bid-rigging among contractors, the Department apparently does not even consider the views of local governments. There is no indication, moreover, that the Department gives any weight to "federalism" principles in any other aspect of merger policy.[89] Only in cable does the Department rely on "the preferences of citizens"[90] to determine whether competition or monopoly is the appropriate market structure. Furthermore, in the largest and most visible of its recent enforcement actions, the Department litigated against and eventually dismantled the Bell System "despite the fairly clear-cut 'preferences of the citizens.' "[91]

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[85] The state action exemption is a judicially created doctrine that finds its genesis in the Supreme Court's decision in Parker v. Brown, 317 U.S. 341 (1943). With regard to application of the state action doctrine to municipalities, *see* Community Communications Co. v. City of Boulder, 455 U.S. 40 (1982); City of Lafayette v. Louisiana Power & Light Co., 435 U.S. 389 (1978).

[86] *See, e.g.*, Town of Hallie v. City of Eau Claire, 471 U.S. 34 (1985).

[87] Even if a city enjoys state action immunity, moreover, there is little reason to extend that protection to decisions on mergers. Although one court has applied the state action doctrine to section 7 of the Clayton Act, 15 U.S.C. § 18 (1982 & Supp. III 1985), *see* Cine 42nd St. Theatre Corp. v. Nederlander Org., Inc., 790 F.2d 1032 (2d Cir. 1986), that court misapplied the doctrine. Congress surely did not intend that Delaware, for example, should be able to immunize otherwise unlawful mergers between Fortune 500 firms from antitrust scrutiny. Moreover, whether or not municipal action for approval of a merger is exempt from antitrust liability, the merger itself may still violate the antitrust laws. *Cf.* City Communications, Inc. v. City of Detroit, 650 F. Supp. 1570 (E.D. Mich. 1987) (even where state action doctrine immunizes city from antitrust liability for its award of exclusive cable franchise, state action immunity does not extend to private defendants).

[88] *Cf.* Brief for the United States as Amicus Curiae at 15, Town of Hallie v. City of Eau Claire, 471 U.S. 34 (1984) (No. 82-1832) ("What *City of Boulder* recognized was that the sheer number of municipalities and other state instrumentalities that may engage in anticompetitive activities creates a significantly greater risk to the Sherman Act's procompetitive values than that created by granting immunity to the states."). For a contrasting view, see Easterbrook, *Antitrust and the Economics of Federalism*, 26 J.L. & ECON. 23 (1983); Brennan, *Local Government Action and Antitrust Policy: An Economic Analysis*, 12 FORDHAM URBAN L.J. 428, 429 n.137 (1984).

The *AT&T*[92] case well illustrates a final deficiency in the Department's cable competition policy. If the issue is whether an industry is a natural monopoly in a given geographic market, the proper way to resolve that question is the marketplace.[93] It has never been presumed that competition may be eliminated by merger even if the market is a natural monopoly. Rather, the test for natural monopoly is the market itself. If, in fact, competition is not sustainable, only one firm will survive the discipline of competition.[94] Indeed, where the evidence is ambiguous, as in

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[89] Although the Department's Phoenix decision relied in part on the fact that municipalities may have the power to prevent consolidation, a similar argument can be made with respect to most antitrust violations, which generally contravene state antitrust statutes. It would be surprising for the Department to decline to bring an antitrust lawsuit merely because a state government had the power to, but did not, act to prosecute the alleged violation.

[90] *See supra* text accompanying note 73.

[91] Owen, *Cable Competition at Sufferance of Cities*, Wall Street J., May 9, 1985, at 28, col. 3.

[92] United States v. AT&T, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom.* Maryland v. United States, 460 U.S. 1001 (1983).

[93] Thus, in cable television, "monopolistic characteristics may lawfully arise only through an elimination bout *in* the market, not by a City-run auction *for* the market." Brief of Tele-Communications, Inc., Time Incorporated and the New York Times Company as Amici Curiae at 30, City of Los Angeles v. Preferred Communications, Inc., 476 U.S. 488 (1986) (No. 85-390) (emphasis in original).

[94] The ABA Section of Antitrust Law has suggested that competition in a natural monopoly will, by definition, be "socially wasteful or futile," and therefore that "legislators and regulators" should make the decision whether a market is a natural monopoly. Regulatory Reform Report, *supra* note 2, at 516. It is clear, however, that the market conditions establishing natural monopoly arise only in the long run. *Id.* In the short run, "even if eventual monopoly is inevitable, competition provides an important guarantee that the winner [of competition for the market] will be the most efficient and responsive competitor, thus benefitting consumers during the period of competition and perhaps afterward as well." Owen, *Regulatory Developments in Cable Television Regulation*, Regulatory Reform: Industry Regulation Committee Newsletter 1 A.B.A. SEC. ANTITRUST L. 5 (Dec. 1985).

*AT&T* itself, the Department has not hesitated in the past to enforce the antitrust laws to maintain potentially competitive markets.[95]

This conclusion is reinforced by the courts' approach to antitrust law and cable competition. If cable's "natural monopoly characteristics" preempt antitrust, it would make little sense for the courts to have considered whether Boulder, Colorado violated the antitrust laws by granting an exclusive franchise,[96] whether a collusive agreement to award a cable franchise in Houston, Texas unreasonably restrained competition,[97] whether an incumbent franchisee in Jefferson City, Missouri monopolized the market by anticompetitive conduct during a refranchising battle,[98] or whether a merger of cable systems in Cobb County, Georgia substantially lessened competition.[99] No court has ruled that natural monopoly is a defense to an antitrust violation.[100] Rather, even *if* the market is a natural monopoly, attempts to limit competition to *become* the monopolist—whether in the franchising process or by means of merger or consolidation—are proscribed by the antitrust laws.[101] The final irony, of course, is that in cable television the fruit of franchising competition, the franchise agreement itself, is largely unenforceable under the Cable Act.[102] Since municipalities can no longer function effectively as surrogate consumers, the central premise of the Department's Phoenix policy collapses.

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[95] AT&T's defense, for example, centered on its alleged efforts to preclude so-called "creamskimming" by long-distance competitors, a slightly more sophisticated version of a "natural monopoly defense." *See* United States v. AT&T, 552 F. Supp. 131, 161-62 (D.D.C. 1982), *aff'd sub nom.* Maryland v. United States, 460 U.S. 1001 (1983).

[96] Community Communications Co. v. City of Boulder, 455 U.S. 40 (1982).

[97] Affiliated Capital Corp. v. City of Houston, 700 F.2d 226, (5th Cir. 1983), *aff'd*, 735 F.2d 1555 (5th Cir. 1984) (en banc), *cert. denied*, 106 S. Ct. 788 (1986).

[98] Central Telecommunications, Inc. v. TCI Cablevision, Inc., 610 F. Supp. 891 (W.D. Mo. 1985) (upholding $36 million verdict against TCI), *aff'd*, 800 F.2d 711 (8th Cir. 1986), *cert. denied*, 107 S. Ct. 1368 (1987). *See* H.R.M., Inc. v. Tele-Communications, Inc., 653 F. Supp. 645 (D. Colo. 1987) (alleging monopolization by one of two cable systems competing in Kearney, Nebraska).

[99] Cable Holdings of Georgia, Inc. v. Home Video, Inc., 572 F. Supp. 482 (N.D. Ga. 1983).

[100] Calls by architects of the "Chicago school" of antitrust for the creation of a "natural monopoly defense" in merger litigation have gone unheeded. *See* Posner, *supra* note 7, at 585-87.

[101] *E.g.*, Fishman v. Estate of Wirtz, 807 F.2d 520, 533, 535 (7th Cir. 1986); Affiliated Capital Corp. v. City of Houston, 700 F.2d at 234 ("[i]f there is to be no competition within a given territory, competition is only possible before the franchise is granted"); Omega Satellite Products Co. v. City of Indianapolis, 694 F.2d 119, 127 (7th Cir. 1982) ("[T]he antitrust laws protect competition not only in, but for, the market—that is, competition to be the firm to enjoy a natural monopoly."). *See also* TV Signal Co. of Aberdeen v. AT&T, 1981-1 Trade Cas. (CCH) ¶ 63,944 at 75,864 (D.S.D. 1981).

[102] *See*, *e.g.*, Tribune-United Cable of Montgomery County v. Montgomery County, 784 F.2d 1227, 1231 (4th Cir. 1986) (Cable Act creates a "federally protected right to modification of commercially impractical [franchise] agreements"). Even those opposing application of the traditional public utility model to cable have stressed that "the

## IV. The Emperor's New Clothes

Two recent developments suggest that the sands of federal policy toward cable television may be shifting. The first, familiar to industry observers, is the application of the first amendment to municipal franchising decisions. The second, proceeding on a somewhat slower track, is the growing trend toward national and regional concentration among MSOs—sparked in part by the industry's aggressive pace of mergers and acquisitions following the Justice Department's approval of the Phoenix transaction.[103]

### A. *Amendment 1 or Section 2?*

In *Preferred Communications, Inc. v. Los Angeles*,[104] a potential entrant challenged the municipality's auction-type franchising process. Preferred alleged that Los Angeles' award of an exclusive cable franchise violated the first amendment.[105] The city, predictably, replied that physical scarcity of pole attachment and conduit space, "economic scarcity" of the medium itself, and the disruptive effect of cable system construction justified restricting cable service to a single company.[106] On appeal from the district court's dismissal of the complaint, the Ninth Circuit reversed.

The Ninth Circuit held that none of these justifications sufficed to limit access by cable systems. Since Preferred alleged that space was available on the poles, the court rejected that basis for excluding a competitor.[107] With respect to "economic scarcity,"[108] the court ruled that even if natural monopoly provided "a basis for some degree of government regulation,"[109] it could

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opportunity of local government, representing the subscribers, to drive a hard bargain with the would-be monopolist may be a viable alternative to conventional methods of regulation." Posner, *supra* note 7, at 562. *See* Easterbrook, *supra* note 88, at 32. Under the Cable Act, however, the bargain is now considerably softer as a matter of law.

[103] In 1986, 340 cable system mergers and acquisitions, involving more than six million subscribers, were consummated. Daniels & Associates, a cable brokerage firm, estimated that the volume of cable transactions nearly doubled from any previous year and equaled the total from 1980 through 1983. *See* COMMUNICATIONS DAILY, Feb. 19, 1987, at 9. One of the largest transactions ever was TCI's $1.25 billion acquisition of United Artists Communications, an MSO serving 740,000 subscribers. *See* Multichannel News, July 21, 1986, at 1.

[104] 754 F.2d 1396 (9th Cir. 1985), *aff'd*, 476 U.S. 488 (1986).

[105] *Id.* at 1399.

[106] *Id.* at 1402.

[107] *Id.*

[108] *Id.* at 1404.

[109] *Id.* at 1405.

not justify the elimination of all competition, particularly where it was alleged that "competition for cable services is economically feasible."[110] Similarly, while the police power justifies some regulation of cable systems, the court held it cannot support the outright exclusion of firms from the market.[111]

The Supreme Court's opinion in *Preferred* is ambiguous because of the case's procedural posture; the underlying facts were never litigated. While confirming that cable television enjoys some modicum of first amendment protection, the Court affirmed and remanded for resolution of the factual issues.[112] Although the Court declined to decide whether cable falls within the much-criticized *Red Lion* doctrine,[113] however, it seems apparent that absolute exclusion of cable entry likely violates the Constitution, *if there is space on the poles*.

The irony is clear. While the Department refuses to enforce the antitrust laws in cable television, either against municipalities or merging cable firms, the first amendment may mandate that competition be permitted—even where a city affirmatively sanctions a cable monopoly. The Ninth Circuit's express rejection of natural monopoly as a justification for excluding potential entrants demonstrates, consistent with the lack of a "natural monopoly defense" to the antitrust laws, that the market should determine whether or not a monopoly is natural.

In short, *Preferred* really should be viewed as an antitrust case in first amendment garb.[114] Indeed, in some ways, it conflicts with first amendment principles, since the ability to restrict entry depends primarily on the content involved, *i.e.*, what is transmitted over the cable. It has never been seriously contended that a city or state may not exclude competition for local telephone service. Thus, the only functional way to distinguish cable systems and telephone companies is that the latter provide two-way communication. It is difficult to conclude, however, that the first amendment should turn on how wires are used to communicate.

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[110] *Id.* at 1404-05.

[111] *Id.* at 1411.

[112] City of Los Angeles v. Preferred Communications, Inc., 476 U.S. 488 (1986).

[113] Red Lion Broadcasting Co. v. FCC, 395 U.S. 367 (1969). In *Red Lion*, the Supreme Court upheld the FCC's "fairness doctrine" on the ground that physical scarcity of the broadcast medium justified greater restrictions on broadcasters' first amendment rights than other members of the press. The viability of the *Red Lion* doctrine has recently been called into question. *See* Meredith Corp. v. FCC, No. 85-1723 (D.C. Cir. filed Jan. 17, 1987); Fairness Doctrine Obligations of Broadcast Licensees, 102 F.C.C.2d 143 (1985).

[114] The Ninth Circuit did conclude that the state action antitrust exemption authorized the city to limit its franchise to a single firm. Nonetheless, the effect of *Preferred* is that under the first amendment, competitive principles override municipal authority even where state action provides immunity under the Sherman Act. Indeed, the court discussed the issue of cable as a "natural monopoly" *only* in the constitutional context. *Preferred*, 754 F.2d at 1404-05. As discussed above, furthermore, the critical issue is who decides whether competition should be permitted; the courts, using the first amendment, have acted where the Department declined to act. *See also* Group W Cable, Inc. v. City of Santa Cruz, No. C-84-7456-WWS (N.D. Cal. Sept. 9, 1987) (permanent injuction issued against municipality based on first amendment); Pacific W. Cable Co. v. City of Sacramento, 798 F.2d 353 (9th Cir. 1986); Tele-Communications of Key West, Inc. v. United States, 757 F.2d 1330 (D.C. Cir. 1985); Carlson v. Village of Union City, 601 F. Supp. 801 (W.D. Mich. 1985); Century Fed., Inc. v. City of Palo Alto, 579 F. Supp. 1553

### B. *Concentration and Competition*

There has been a striking increase in concentration among MSOs in recent years. This trend raises a variety of new regulatory and competitive issues, only some of which are addressed in the pending petition for FCC rulemaking to establish rules governing MSO concentration.[115]

Identifying the manner in which MSOs compete presents one issue. While it is clear that franchising competition has often been heated, it is not clear that, with most major franchises already awarded, refranchising competition will prove either substantial or effective. As a matter of merger policy, therefore, it may be premature to impose quantitative or relative limits on MSO cable system holdings. Nonetheless, concentration in cable raises other potentially significant competitive issues, both horizontal and vertical.

As MSOs increase *regional* concentration of cable systems, cable is likely to become a stronger competitor in the television advertising market, able to offer advertisers the audience

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(N.D. Cal. 1984). *See generally* Note, *Access to Cable, Natural Monopoly, and the First Amendment*, 86 Colum. L. Rev. 1663 (1986).

Interestingly, the major MSOs now suggest that they support the use of first amendment principles to encourage direct competition among cable operators. *See* Brief of Tele-Communications, Inc., Time Incorporated and the New York Times Company as Amicus Curiae at 27-28, City of Los Angeles v. Preferred Communications, Inc., 476 U.S. 488 (1986) (No. 85-390) ("Even assuming that cable is usually a natural monopoly, the First Amendment dictates that the choice of which company is to receive the monopoly in this form of communication must be made by competition in the marketplace of ideas—not be municipal officials."). *Id.* at 27-28 ("Whatever the current technological limit to the number of systems may be, it is well above four."); *id.* at 16 ("[T]he tendency toward monopoly, if present at all, may well be attributable more to governmental action . . . than to any 'natural' economic phenomenon.") (citing Quincy Cable TV, Inc. v. FCC, 768 F.2d 1434, 1450 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 2889 (1986)).

[115] Petition for Rule Making, Amendment of Part 76, Subpart J of the Commission's Rules and Regulations Relating to Multiple Ownership of Cable Television Systems, RM-5475 (Feb. 21, 1986). *See* 1 C. Ferris, F. Lloyd & T. Casey, *supra* note 22, ¶ 9.23, at 9-53; *MPAA Leads Charge in Urging Limits on Cable Ownership*, Multichannel News, July 28, 1986, at 1 (Motion Picture Association of America supports MSO concentration limits); *cf.* CATV Multiple Ownership, 91 F.C.C.2d 46 (1982) (rejecting limits on MSO concentration).

volumes now generally possible only on broadcast television.[116] Consequently, cable systems could gain an incentive, acting either unilaterally or through cooperative advertising "interconnects,"[117] to impede competition from broadcast stations for advertising, for example, by denying local stations carriage.[118] *Preferred* suggests that there is room in the continuing first amendment dispute over the must-carry rules[119] for such competitive issues.

Horizontal MSO concentration may also intensify competitive concerns arising in the acquisition of programming. Although the trend may be pro-competitive, as any MSO market power would offset that enjoyed by the dwindling number of programming distributors, it is questionable whether cable programmers can exert significant economic pressure on cable operators. If systems drop their services, satellite-delivered programmers will lose their most important outlet. Indeed, coupled with vertical integration by MSOs (which itself seems on the rise), horizontal concentration could increase incentives for anticompetitive practices aimed at nonintegrated competitors.[120] Several antitrust lawsuits arising out of the refusal by vertically integrated MSOs to supply programming to competing cable systems,[121] or to carry satellite-delivered services offered by competing programmers,[122] are pending.

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[116] *See* Communications Daily, Feb. 19, 1987, at 3 (National Association of Broadcasters warns that "[c]able poses potentially serious threat to broadcasters in local retail advertising").

[117] "Interconnects" are technical or reciprocal arrangements among cable systems that provide advertisers access to all systems involved. *See* C. Ferris, F. Lloyd & T. Casey, *supra* note 22, ¶ 5.04(d), at 5-12.

[118] Wodlinger Broadcasting Co. v. MTV Networks, Inc., No. H-85-5811 (S.D. Tex. filed 1985) (LPTV station with music video format alleges antitrust violation arising from denial of carriage and advertising access by vertically integrated MSO); *cf.* Midland Telecasting Co. v. Midessa Television Co., 617 F.2d 1141 (5th Cir.) (reversing dismissal of antitrust claim arising from refusal of cable system to carry VHF station that competed with system's parent broadcasting companies), *cert. denied*, 449 U.S. 954 (1980).

[119] *See* Quincy Cable TV, Inc. v. FCC, 768 F.2d 1434 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 2889 (1986); Amendment of Part 76 of the Commission's Rules Concerning Carriage of Television Broadcast Signals by Cable Television Systems, 1 F.C.C. Record 864 (1986). In partially resurrecting a modified version of its must-carry rules, which had been invalidated in *Quincy Cable*, the FCC found that "a competitive market may not lead cable operators to carry all of the television signals that can be received off-the-air in their communities [and that] satellite programmers' current primary means of access to viewers is through cable systems." *Id.* at 881. In early 1987, the FCC stayed the new, modified must-carry rules. *See* 3 FCC Rulemaking Rep. (CCH) ¶ 23,112 (1987).

[120] *See* United States v. Columbia Pictures Indus., Inc., 507 F. Supp. 412, 424 (S.D.N.Y. 1980); Kahn, *supra* note 7, at 24; Noam, *supra* note 20, 353.

[121] *E.g.*, Nishimura v. Dolan, 599 F. Supp. 484 (E.D.N.Y. 1984); Mobile Cablevision v. Group W Cable, No. 86-0043-H-S (S.D. Ala. filed Jan. 10, 1986).

[122] *E.g.*, New York Citizens Comm. on Cable TV v. Manhattan Cable TV, Inc., 651 F. Supp. 802 (S.D.N.Y. 1986) (denying motion to dismiss monopolization claim against

These issues cannot be dismissed as mere long-run concerns, but it appears they will not be addressed in the FCC's MSO concentration proceeding.[123] That proceeding, however, has already produced at least one surprise. The Department, in opposing regulatory restrictions on horizontal concentration, repeatedly emphasized the role of antitrust law in policing anticompetitive mergers.[124] While the Department did not cite, let alone harmonize, its decision in the *Phoenix* case, one may wonder whether there has been a retrenchment. Given the Department's failure to act on recent large MSO mergers, however, its reliance on antitrust enforcement exhibits a rather hollow ring.

## V. THERE AND BACK AGAIN

Those without an understanding of cable television history may find that history repeated in policy issues likely to arise in the future. A case in point is scrambling.[125] While the headlines abound with the political battles between satellite dish retailers, cable operators, and cable programmers over scrambling,[126] a key competitive issue has not been resolved. Indeed, if cable systems, including vertically intergrated MSOs, control the retail distribution of satellite-delivered programming, then the definition of the product market applicable to cable[127]—the basic source of the conundrum in antitrust and regulatory policy—may make a practical difference.

The antitrust concern is that, whether or not alternative distribution technologies are now "effective competition" for cable

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vertically integrated MSO arising out of refusal to carry unaffiliated pay cable services). For a discussion of a 1983 lawsuit regarding the refusal by Group W, which at that time was a vertically integrated MSO operating a competing cable news service, to carry CNN, see 2 C. Ferris, F. Lloyd & T. Casey, *supra* note 22, ¶ 24.07[3], at 24-24.

[123] *See supra* note 115 and accompanying text.

[124] Comments of the United States Department of Justice In the Matter of Amendment of Part 76 at 2, 7, 8, 9, RM-5475 (F.C.C. filed July 21, 1986). In a curious, off hand remark, the Department also opined that the proposed limits on MSO concentration "might unnecessarily confuse the relationship between the antitrust laws and FCC regulations (for example, by raising questions of primary or exclusive jurisdiction) that might actually weaken the antitrust laws' ability to prevent anticompetitive acquisitions." *Id.* at 2.

[125] Scrambling is the coding, or encryption, of satellite television signals so that receipt is possible only through purchase and use of specialized equipment. *See* Cable Act § 605, 47 U.S.C. § 605 (Supp. III 1985).

[126] *See, e.g.*, *Gore Seeks FTC Probe of Cable Program Marketing to Dish Users*, Communications Daily, Feb. 24, 1987, at 2; Ivey, *Angry 'Dish' Owners Try to Fight Off Scrambled Signals*, Bus. Wk., Jan. 13, 1986, at 120.

[127] If and when these antitrust issues reach the courts, "[i]t is quite clear [that the issue of product market definition] will be heavily litigated [and] is likely to lead to difficult and potentially conflicting decisions." 2 C. Ferris, F. Lloyd & T. Casey, *supra* note 22, ¶ 24.09[2], at 24-25 to 24-26.1.

systems, the industry appears determined to grant cable systems the exclusive right to "descramble" satellite-delivered programming. For example, in 1985, NCTA proposed that a consortium limited to cable operators would market decoders to satellite earth station owners.[128] Yet, while this approach remedies some fairly obvious antitrust concerns,[129] there is little reason to believe that vertically integrated MSOs will allow unaffiliated dish retailers or SMATV or MDS operators to distribute satellite programming also carried on owned-and-operated cable systems.[130] A little strategic anticompetitive behavior, therefore, could go a long way to ensure that cable retains its inherent economic advantage as a multichannel, broadband distribution medium.[131]

The Department has apparently continued its lengthy and well-publicized antitrust investigation into the distribution of satellite programming.[132] While it appears that there may be no easy answers to these issues under prevailing antitrust law—and little direct precedent in reported cases—scrambling could eventually become the Department's vehicle for limiting the reach of its *Phoenix* decision. If *Phoenix* represents a judgment by the Department that antitrust essentially does not apply to cable television, then cable systems could squelch "intermodal" competition[133] from alternative delivery technologies with little restraint. In that event, of course, the dispute about the product market will have proved irrelevant; even if the FCC's broad video programming market were correct, cable will have monopolized.

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[128] *See Noting Problems, Antitrust Experts Praise NCTA's Scrambling Plan*, Multichannel News, Aug. 5, 1985, at 3, col. 1.

[129] For example, earlier proposals included express provisions that would have prohibited cable systems from marketing descrambled satellite programming within the franchise areas of any other systems. *Id.*

[130] For a discussion of several antitrust cases involving the refusal of cable programmers to sell to SMATV operators, see 2 C. FERRIS, F. LLOYD & T. CASEY, *supra* note 22, ¶ 24.09[4] at 24-30. For examples of cable operators' efforts to preclude competition from satellite dish retailers, SMATV operators, and other potentially competitive technologies, see e.g. Rollins Cablevue, Inc. v. Saienni Enter., 633 F. Supp. 1315 (D. Del. 1986); Air Capital Cablevision, Inc. v. Starlink Communications Group, Inc., 601 F. Supp. 1568 (D. Kan. 1985).

[131] *See A Cable Cartel?*, FORBES, Feb. 10, 1986, at 82; N.Y. Times, Jan. 13, 1986, at A16, col. 1.

[132] *See, e.g., Justice Continues Inquiry into Scrambling, SMATV/MMDS Policies*, Multichannel News, Dec. 22, 1986, at 1. Throughout 1986 and 1987, however, the focus of scrambling issues appeared to be moving away from the Department's antitrust investigation and toward the regulatory and legislative arenas. The FCC began its own inquiry into scrambling issues, eventually reporting that "markets are evolving [which will] likely prove efficient and workably competitive." Scrambling of Satellite Television Signals and Access to Those Signals by Owners of Home Satellite Dish Antennas, 2 F.C.C. Record 1669, 1671 (1987). There was also increased activity in Congress. *See Senate Committee Blisters Cable Industry*, Multichannel News, Aug. 4, 1986, at 6. In 1986, Senator Gore introduced a bill to require cable programmers to market to dish owners and to preclude discrimination against non-cable distributors of decryption technology. S. 2823, 99th Cong., 2d Sess. (1986). Senator Gore argued that "it does not take a year-long general study by [the] Justice Department or the FCC to realize that the distortions in this marketplace are severe and need immediate remedy. We simply cannot wait forever for those agencies to study the problem to death." 132 CONG. REC. S9,898 (daily ed. July 30, 1986) (statement of Sen. Gore). This bill was defeated by a close 54-44 vote near the end of the 99th Congress. *See* 132 *Cong. Rec.* S14,674 (daily ed. Oct. 2, 1986). Opposition to the bill was based, in part, on the ground that it was premature because "the cable industry's market power is being studied by the FCC, and allegations of unlawful, collusive conduct is under active investigation by the Justice Department." 132 CONG. REC. S14, 671 (daily ed. Oct. 2, 1986) (remarks of Sen. Wilson). Shortly after the FCC's 1987 report, bills similar to Senator Gore's 1986 legislation were introduced into both houses of Congress. *See* S. 889, 100th Cong., 1st Sess. (1987); H.R. 1885, 100th Cong., 1st Sess. (1987). Senator Gore characterized the FCC's conclusions as "cursory

Without access to the evidence, it is impossible to decipher the precise issues now being examined by the Department or assess the competitive reasonableness of restrictions involved in the various scrambling scenarios implemented since 1986.[134] This much appears self-evident, however. Whether cable systems are subject to competition depends on the nature and number of alternative programming sources available in the market in question.[135] If anticompetitive means are used to exclude some of that programming, serious antitrust issues are presented. Even if cable is a natural monopoly, therefore, it must abide by the antitrust laws in its relations with competitors—at least some of them, some of the time.

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and ideologically colored." *Satellite "Fair Marketing" Bills Introduced in House, Senate*, Multichannel News, Apr. 6, 1987, at 38, col. 2. In July 1987, the Department suggested that its investigation into scrambling was continuing but offered little hope of quickly reaching a definitive conclusion. *See infra* note 134.

[133] This term refers to competition among different modes of delivering goods or services, *e.g.*, between cable systems and alternative delivery technologies such as SMATV. *See* Scrambling of Satellite TV Signals, Notice of Inquiry, 104 F.C.C.2d 1444, para. 2 (1986).

[134] In July 1987, the Department announced that its scrambling investigation had not of date uncovered any "significant evidence" of collusion among cable programmers or cable operators. *Hearings Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce*, 100th Cong., 1st Sess. 2-3 (1987) (statement of Charles F. Rule, Acting Assistant Attorney General). The Department's investigation into restrictions imposed on the distribution of scrambled programming, which is typically limited only to cable system operators, apparently continues. In the mean time, at least one antitrust suit has already been brought by those involved in the home earth station market alleging that cable programmers have conspired to restrain competition from third-party "packagers" of satellite programming. Personal Preference Video v. Home Box Office, Inc., No. CA-40-86-235-K (N.D. Tex. filed Mar. 25, 1986).

[135] *See* HOUSE REPORT, *supra* note 10, at 66 ("effective competition" determined by "consider[ing] the number and nature of services provided [by the cable system], compared with the number and nature of services available from alternative sources and, if so, at what price").

Attachment No. 3

# Vertical Integration

## The business behind the boom in cable programing

*The setting is the Denver office of the chief executive of a major MSO. On the other side of the desk is someone with a "great idea" for a new cable programing service.*

*Programer:...It's a goldmine.*

*CEO: Mmmmm.*

*Programer: Well, we'll give operators an equity interest.*

*CEO: Mmmmm.*

*Programer: OK, we'll give you 51% ownership, but not a dime more.*

*CEO: Mmmmm.*

*Programer: OK, OK, you can have 80%, but I've got to have 20% to meet payroll.*

An exaggeration? Yes. But in the past 18 months, cable operator ownership and equity participation—the foot soldiers of vertical integration—have rapidly become the quid pro quo for launching new services.

There are a number of reasons why this method of financing/distribution has come into vogue. Cable operators see equity participation as a way to insure that services they feel their subscribers want will see the light of day. It gives cable operators greater, or in some cases, total control over the service. As industry proponents call for cable-exclusive programing to differentiate themselves, owning programing services takes on more allure. For many years, and to a lesser extent today, the cable industry has been criticized for relying on warmed over network or syndication reruns. Flush with cash from the completion of most system construction, and freed from local rate regulation, cable operators have the money to plow back into programing. And they are using some of that money to take equity stakes in programing services.

But although cable operators look at equity as a way to acquire a wider range of programing, and much that otherwise might not be produced, critics see the same development as an attempt by cable operators to hoard product and an example of an insensitivity to exclusivity arrangements that have helped cable prosper.

Programers who have tried to launch services in the past 18 months have found the shelf space dwindling. Channel capacity is as tight today on cable systems as it was in the early 80's. Although the situation is expected to ease somewhat by the early 1990's, as the last of the major urban builds are finished and system upgrades continue, cable operators are wondering how many more services can be added, since in the end consumers wind up paying for them.

Today's capacity crunch, which threatens to postpone the launch of the one of the industry's most solidly backed services, Turner Broadcasting System's Turner Network Television, is causing potential programers to offer equity stakes to operators to insure carriage. Most of the equity ventures that have launched in the last year and a half have a telemarketing feature, such as the Travel Channel, The Fashion Channel and the QVC Network. But other services have launched, although on a much lower scale, without equity offerings, the Consumer Discount Network and Movietime, for example. You TV and Teleworld are also on the drawing boards for launch next year, but neither came out of the blocks with equity participation ast part of its company structure.

Financial News Network's Meister

Fashion Channel's Herman

ATC's Dressler

"An equity deal is wonderful for initial distribution, and it secures a lot of different fronts," says Sheri Herman, vice president, sale and marketing, Fashion Channel, which launched with 65 equity cable operator partners. "But work still has to be done on a day-to-day basis to make sure it's a working partnership. If you don't have that, the best equity deal in the world won't matter."

David Meister, Financial News Network director, has launched services with and without equity. "In reality, what you have, no matter what the piece of paper between the two entities, is an inherent partnership in the promotion of a cable programing service to the consumer," says Meister. "in that process, a deal is going be made, whether you call it equity, revenue sharing, affiliate fee, commission or whatever. If it isn't a reasonable and fair deal, the whole thing breaks down."

Cable operators, although coming from a different perspective, also find that the equity-carriage element is a very important part, but that aspect alone won't carry a service. Still, some operators are more bullish than others when it comes to ownership or equity participation. Bob Redella, vice president, programing and investments for Cox Cable, lists what's important for getting a new service off the ground: "All the pieces really have to fit. The service has to be quality. It has to have a continuous flow of programing. It has to have good management. It has to have the necessary finances and finally it has to have carriage." Cox has taken a strong position in program service ownership, through the Discovery Channel, Home Premiere Television and its own home shopping service, America's Shopping Club. But the key question in launching a new service, said Redella, whether equity or ownership stakes are involved, is: "Is the programing of quality value for the consumer?"

Taking a bit more cautious approach is American Television & Communications, the second largest MSO. "We are not out looking for equity positions in cable services," said Fred Dressler, vice president of programing. "We understand why people are offering equity, but it's our position that we'd rather make decisions on the value of the product and not the value of the investment."

### While we're on the subject

An extended discussion on the approaches of various MSO's to ownership in program services, and an examination into why programers offer equity in order to gain distribution, continues on page 66. A list of the principal regional sports programing services, many owned by cable MSO's, appears on page 67.

## Who owns what with whom in cable networking

**Basic services**

| *Network* | *Subscribers* | *Ownership* |
|---|---|---|
| ***ESPN*** | 44,300 | Capital Cities/ABC (80%), RJR Nabisco (20%) |
| ***WTBS*** | 41,642 | Turner Broadcasting (Ted Turner 65%, Time Inc. **[ATC]** 11.5%, **TCI** 10.1%, **UA** 4.8%, **United** 3.2%, **Warner** 1.8%) |
| ***CNN*** | 41,642 | Turner Broadcasting (Ted Turner 65%, Time Inc. **[ATC]** 11.5%, **TCI** 10.1%, **UA** 4.8%, **United** 3.2%, **Warner** 1.8%) |
| ***USA*** | 39,000 | MCA (50%), Paramount (50%) |
| ***MTV*** | 37,100 | MTV Networks Inc. **(Viacom)** |
| ***Nashville*** | 36,000 | Gaylord Broadcasting |
| ***CBN*** | 35,834 | Christian Broadcasting Network |
| ***Nickelodeon*** | 35,800 | MTV Networks Inc. **(Viacom)** |
| ***Lifetime*** | 32,300 | CC/ABC (33%), **Viacom** (33%), **Hearst** (33%) |
| ***Weather Chan.*** | 31,053 | Landmark Communications (former parent of TeleCable) |
| ***Nick at Nite*** | 31,000 | MTV Networks Inc. **(Viacom)** |
| ***Headline News*** | 28,352 | Turner Broadcasting (Ted Turner 65%, Time Inc. **[ATC]** 11.5%, **TCI** 10.1%, **UA** 4.8%, **United** 3.2%, **Warner** 1.8%) |
| ***FNN*** | 27,000 | Infotech (20%), Dr. Earle Brian (15%) |
| ***A&E*** | 27,000 | CC/ABC (33%), NBC (33%), **Hearst** (33%) |
| ***Discovery*** | 25,600 | **TCI** (14%), **United** (14%), **Cox** (14%), **Group W** (14%), **Newhouse** (14%), management, New York Life Co., Allen & Co. (30%) |
| ***C-SPAN*** | 23,000 | **Cable operator supported** |
| ***VH-1*** | 22,900 | MTV Networks Inc. **(Viacom)** |
| ***WGN*** | 22,481 | Tribune Broadcasting |
| ***Score*** | 19,800 | Infotech (20%), Dr. Earle Brian (15%) |
| ***CVN*** | 19,000 | COMB Co. (50%), **18 cable operators*** (50%) |
| ***BET*** | 15,000 | Bob Johnson (51%), BET president, **TCI** (16%), **HBO** (16%), **Taft** (16%) |
| ***HSN I*** | 13,500 | Home Shopping Networks Inc. |
| ***C-SPAN II*** | 12,500 | **Cable operator supported** |
| ***Tempo TV*** | 12,500 | **TCI** (pending owner) |
| ***Telshop*** | 11,000 | Infotech (20%), Dr. Earle Brian (15%)** |
| ***QVC Network*** | 10,747 | QVC Network (65%), **Comcast** (14%), **cable operators** (21%)*** |
| ***Inspirational*** | 10,700 | PTL Club |
| ***Learning Chan.*** | 10,300 | Infotech (40%), Appalachian Community Service Network (40%), officers and employes (20%) |
| ***WWOR*** | 10,100 | MCA |
| ***Silent Network*** | 10,100 | Silent Network Inc. |
| ***Video Mall Net.*** | 10,000 | Video Shopping Mall (Goodway Marketing 80%) |
| ***Trinity*** | 7,200 | Trinity Broadcasting Network (nonprofit) |
| ***Eternal Word TV*** | 7,100 | Eternal Word Television (nonprofit) |
| ***Fashion Channel*** | 7,000 | Charlie Gee (32%), **65 cable operators** (25%)**** **TCI** (10.5%), **United** (10.5%) |
| ***Country Music*** | 6,700 | Jim Guercio (principal owner) |
| ***Acts*** | 6,000 | Southern Baptist Convention |
| ***Travel Channel*** | 5,700 | TWA Marketing (100%), after equity offering TWAM will hold 63%, **cable operators** 37%***** |
| ***HSN II*** | 4,200 | Home Shopping Networks Inc. |
| ***Movietime*** | 3,200 | Employes (30%), Mabon, Nugent & Co., SRK Management, Loeb Partners and Hallmark (70%) |
| ***Shop TV*** | 2,500 | JC Penney (63%), STN (37%)****** |
| ***WPIX*** | 2,471 | Tribune Broadcasting |
| ***Hit Video USA*** | 2,100 | Wodlinger Broadcasting |
| ***KTVT*** | 1,891 | Gaylord Broadcasting |
| ***Nostalgia*** | 1,400 | **Cooke Cablevision** (9%), **TeleCable** subsidiary has small percentage, largest single owners |
| ***Liberty*** | 1,049 | Liberty Broadcasting Network (nonprofit) |
| ***Consum. Disc. II*** | 1,000 | Entertainment Marketing Inc. |
| ***Sky Merchant*** | 1,000 | Jones Int'l. (parent of **Jones Intercable**) |
| ***America's Shop.*** | 1,000 | **Cox Cable** |
| ***Galavision*** | 900 | Univisa |
| ***Gospel Music Net.*** | 844 | GMN Ltd. |
| ***Motivation Net.*** | 600 | Rock Christian Network (nonprofit) |
| ***CDN I*** | 526 | Entertainment Marketing |

### Pay services

| *Network* | *Subscribers* | *Ownership* |
|---|---|---|
| ***HBO*** | 15,000 | **Time Inc.** |
| ***AMC*** | 7,000 | Rainbow Program Enterprises **(Cablevision Systems)** 50%, **TCI** 50% |
| ***Showtime*** | 5,300* | **Viacom** |
| ***Cinemax*** | 4,100 | **Time Inc.** |
| ***Disney*** | 3,175 | Walt Disney Co. |
| ***Movie Channel*** | 3,000* | **Viacom** |
| ***Playboy*** | 520 | Playboy Enterprises |
| ***Bravo*** | 500 | RPE **(Cablevision Systems)** |
| ***Festival*** | 30 | **Time Inc.** |

*Estimate. Showtime does not breakout figures for Showtime/The Movie Channel

### Pay-per-view services

| | | |
|---|---|---|
| ***View. Choice I,II*** | 4,000 | **Viacom** |
| ***Request TV*** | 2,500 | **Daniels, United Cable, Centel, Heritage, American,** major motion picture studios |
| ***Home Premiere*** | 2,300 | **ATC, Cox, TeleCable, Continental** and **Newhouse** 20% each. |
| ***Cable Video Store*** | 40 | General Instrument |

Bold face in right-hand column indicates cable operator ownership or ownership by company with cable systems in separate subsidiary

*CVN—The ownership by **18 cable operators—American, ATC, Adam Corp., Cablevision, Colony, Continental, Cooke, Daniels & Associates, Heritage, Newhouse, Rogers, Sammons, TCI, Times Mirror, United Artists, United, Viacom, Warner**—is based on percentage of subscribers committed to service.

**Telshop—FNN is offering equity to **cable operators** (500,000 shares). FNN will retain two million shares.

***QVC Network—It is presenting owned by the public (65%), **Comcast** (14%) and **cable operators** (21%). When cable operators exercise warrants on 483,000 shares of preferred stock, redeemable for 10 shares of common stock, another 4.83 million shares will be added to the approximately 10 million shares outstanding. At that point, cable operators would own approximately 8.5 million shares of the 15 million shares outstanding, or 56% of the service. The largest in that group would be **TCI** (2,150,000).

****Fashion Channel—Among the larger cable operators with an equity stake are **Adelphia, American, ATC, Barden, Bresnan, Cablevision Industries, Centel, Century, Colony, Commonwealth Cablesystems, Continental, Cooke, Cox, Daniels, Enstar, First Carolina, Herron, Hauser, Heritage, Lenfest, Maclean Hunter, Marcus, Media General, Newhouse, Omega, Post Newsweek, Prestige, Sammons, Scripps Howard, Simmons, Susquehanna, Sutton Capital, Taft, TeleCable, TCI, Times Mirror, Triax, UA, United, United Video Cablevision, Viacom** and **Warner**.

*****Travel Channel—The final equity offering is to be placed by Dec. 1, whereby TWA Marketing will retain 6 million shares and **cable operators** will be offered 3.5 million.

******Shop TV—It has equity commitments from **30 MSO's** representing 3.3 million subscribers. MSO's will receive **1%** equity in the service for each million homes they commit to. Cable operators who have major stakes in other shopping programs, such as TCI, United and Comcast, are not a part of Shop. Among the MSO's whose systems are carrying Shop TV are Cablevision Systems, Rogers, Continental and Warner.

# TVRO's win round one on regulation

**Commerce passes Gore-Ford bill; major fight expected on floor; It permits third parties to distribute cable program services to dish owners**

The home satellite dish industry scored an initial victory last week when the Senate Commerce Committee adopted legislation (S.889) to regulate the TVRO marketplace. Still, final Senate passage is not a given; indeed, the battle is apt to intensify as it heads for a final floor vote. Proponents are hoping to see it move before Congress adjourns and are already laying the groundwork for House consideration.

Despite Commerce's action (it was approved by voice vote) there was some dissention. The Communications Subcommittee chairman, Daniel Inouye (D-Hawaii), thinks the measure is wrongheaded and promises to fight it on the floor. Inouye could be joined by Bob Packwood of Oregon, the ranking Republican on the subcommittee, who although absent from the debate (he was a participant in the White House-congressional budget summit), is known to oppose the bill as it was reported from committee. Ted Stevens (R-Alaska) also has problems with it.

S.889 would mandate that cable programers permit any qualified third party—inside and outside the cable industry—to distribute their services to dish owners. (To assuage some concerns, this provision was modified to "allow reasonable programer judgments to be made in qualifying distributors.") Proponents of the bill believe competition among multiple third-party distributors would keep prices of programing low enough to satisfy dish owners and bolster the sagging home satellite industry by making dish ownership more attractive to consumers.

Even those who favor S.889—Senators Pete Wilson (R-Calif.) and Larry Pressler (R-S.D.), for example—indicated they'll seek further refinements. Senator John Kerry (D-Mass.) expressed doubts about the need for such a bill and, according to staff, may offer some amendments. "A lot of work has to be done.... It's not over," said one Senate aide.

The controversial measure pits cable against the home satellite industry and has been the subject of a massive grassroots campaign by dish owners, dealers and manufacturers for several years; they failed by a vote of 55 to 45 to pass a TVRO bill in the Senate last year. But this time proponents feel the numbers are on their side. "This is far from over but we're really on the right track," said Fred Finn, president of the Home Satellite Television Association. The Satellite Broadcasting & Communications Association applauded the committee's actions and is hopeful the "momentum will carry over to the House side," said President Chuck Hewitt.

Senators Al Gore (D-Tenn.) and Wendell Ford (D-Ky.), the legislation's principal sponsors (along with Dale Bumpers [D-Ark.]), were equally pleased. Following the vote, Gore told reporters he is confident the measure will receive full Senate approval. "I am very pleased with where we are today," said Ford, who added, "those win-them-all's [an obvious reference to cable's numerous legislative and regulatory victories] are going to lose one."

Cable was not viewing the committee's action as a terminal blow. It was a case of the opponents choosing "not to have the fight in committee but on the floor," said National Cable Television Association President Jim Mooney. Nor does Mooney think the bill will be enacted because, he said, "it is fundamentally flawed. It is a solution in search of a problem and we will continue to oppose it."

Electronic Media *October 6, 1986*

# Some MSOs pre-empting FNN's shopping service

**By RICHARD TEDESCO**
Staff reporter

New York—By adding six hours of home shopping to its daily schedule, Financial News Network has sparked dissatisfaction among some multiple system operators carrying the cable TV service.

Some operators, in fact, are pre-empting the home shopping segment, which is called TelShop.

"FNN is a fine financial service," says Nimrod Kovacs, vice president of programing and marketing for United Cable Television, which is among the MSOs refusing to carry TelShop, "but we don't carry FNN for shopping services."

Several MSOs affiliated with FNN complain that they weren't officially notified before the TelShop home shopping service was dropped into the midnight-to-6 a.m. time (ET) slot on the FNN schedule in early August. FNN denies the allegation.

TelShop faces competition from the already established Home Shopping Network and from the Cable Value Network.

Several MSOs, including United Cable, have equity positions in the latter venture and aren't willing to carry the rival TelShop service.

As Mr. Kovacs sums up, "We don't want to bombard the subscribers with home shopping services. (And) we want to support the services where we have an equity interest."

Other MSOs that are partners in the CVN venture include Tele-Communications Inc., American Television and Communications Corp., Daniels & Associates, Rogers Cablesystems and Warner Cable Communications.

Continental Cablevision, one of the big players not participating in CVN, has also remained cool to TelShop.

"We're discussing it with them," says Robert Stengel, Continental's vice president of programing, "and we've told them we're not pleased with the way they went about it, in changing the programing that way."

Adds Patrick Mellon, director of programing for Telecable Corp., "To offer cherry-picked or part-time services for the subscriber would confuse them and cannibalize the services."

Despite the seeming obstacles to its plunge into home shopping, FNN executives voice optimism about TelShop and say they've heard no MSO complaints.

Arnold Rosenthal, FNN's senior vice president of affiliates and marketing, says the TelShop universe is big enough to handle the new home shopping service.

"There's enough profit for anybody to prosper with 10 million homes," Mr. Rosenthal says. "Our systems are the big systems."

Mr. Rosenthal says MSOs carrying TelShop on at least some of their systems include Storer Communications, Cox Cable, United Artists Cablevision and Jones Intercable.

Meanwhile, FNN is moving even deeper into home shopping. The cable service announced last week that it will seek channel space for a 24-hour TelShop operation and will deliver it via its own transponder.

The six hours of TelShop programing will continue to run, as scheduled, as part of regular FNN programing.#

Attachment No. 4

WEEKLY Television Digest

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# Cable Report to the President

By the Cabinet Committee on Cable Communications

**Issued Jan 16, 1974. Members of Committee: Clay T. Whitehead, Director of the Office of Telecommunications Policy, chairman; Leonard Garment, Herbert G. Klein, Presidential Advisers; Peter G. Peterson, Secretary of Commerce; Elliot L. Richardson, Secretary of Health, Education & Welfare; George Romney, Secretary of Housing & Urban Development**

OFFICE OF TELECOMMUNICATIONS POLICY

EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON, D.C. 20504

January 14, 1974

**DIRECTOR**

The President
The White House
Washington, D.C.

Dear Mr. President:

I am pleased to submit to you the report of the Cabinet Committee on Cable Communications. As you requested, the Committee has developed proposals for a new policy that will allow cable to be integrated into our nation's communications media in an orderly way that is consistent with the principle of the free flow of information so deeply imbedded in our national traditions.

During the Committee's deliberations, we heard the views of a wide range of industry groups and nonprofit and public interest organizations, and we also examined the extensive research on cable communications. On the basis of the views we heard, the research we examined, and our own study and deliberations, the Committee has recommended a comprehensive, new national policy for cable communications.

Our goal was to insure that cable would develop as a communications medium open and available to all Americans free of private or governmental barriers to its use. Under such a policy, we believe that cable can be a communications medium that allows the great creativity of the American people to express itself.

Sincerely,

Clay T. Whitehead

Distributed without charge to subscribers of Television Digest. Extra copies, $2.50 each, 10 or more, $1.50 each

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**Industry Structure: Disbribution**

*Recommendation 1:* Control of cable distribution facilities should be separated from control of programming and other services provided over the channels on those distribution facilities.

*Recommendation 2:* Common ownership or control of cable systems, interconnection facilities, and program supply services should be the only form of cable "network" operation that should be prohibited.

*Recommendation 3:* There should be no restrictions on either cross-media ownership or multiple ownership of cable systems.

*Recommendation 4:* Telephone common carriers should not control or operate cable systems in the same areas in which they provide common carrier services.

**Industry Structure: Programming** 12

*Recommendation 5:* The development of new programming and other information services that can be offered over cable should not be impeded by government-established barriers to the consumers' opportunity to purchase those services.

*Recommendation 6:* The programming, information or other services provided over cable should not be subject to administrative regulation of content, nor should the prices of such services be regulated by any governmental authority.

*Recommendation 7:* Incentives to create programming for cable should be fostered by full applicability of the copyright laws to cable channel users.

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*Recommendation 8:* The Federal Government's authority over cable should be exercised initially to implement a national policy, thereafter, detailed Federal administrative supervision should be limited to setting certain technical standards for cable and applying anti-siphoning restrictions on professional sports programming.

*Recommendation 9:* Franchising authorities should have the principal responsibility for the regulation of cable systems.

- a. Prohibition on public utility-type rate-of-return regulation.
- b. Prohibition on grants of exclusive franchises.
- c. Prohibition on use of franchise fees as general revenue-raising devices.
- d. Prohibition on dedicated "free" channels.
- e. Requirement of adequate channel capacity.
- f. Requirement of nondiscriminatory channel lease rates.
- g. Miscellaneous franchise provisions.

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*Recommendation 10:* There should be strong legal and technical safeguards to protect individual privacy in cable communications.

*Recommendation 11:* Governmental authorities should assure that basic cable or other broadband communications are available to residents of rural areas and to the poor.

*Recommendation 12:* Participation by minority groups in cable system ownership, operation and programming should be facilitated.

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Summary Outline of Recommendations

- A. Policies Affecting Cable System Operators
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Appendix 23
Current Regulatory Framework

# INTRODUCTION

> *"The Committee did not attempt to assign a role for cable or choose a place for it in the future of communications in this country, nor have we treated it as a modern day Rosetta stone capable of unravelling the complex problems facing this society. We have simply concluded that cable has much to offer, and it should be given an opportunity to prove its worth to the American people in the marketplace of goods and services and in the marketplace of ideas."*

On June 27, 1971, the President announced the formation of a Special Committee[1] to develop proposals for a comprehensive national policy on cable communications. In creating the Committee, the President noted that communications have a profound impact on the social fabric of our nation and that it was time to come to grips with cable communications in order to avoid the social, economic, and regulatory instability that this technological innovation could cause.

Early in the course of its work, the Committee established an interagency working group, which held many formal meetings and was in regular contact on an informal basis. In addition to the departments and agencies represented on the Committee, the working group coordinated its activities with other interested governmental organizations, including the Department of Justice and the Federal Communications Commission (FCC).

The Committee also heard the views of industry groups as well as a wide variety of nonprofit and public interest organizations. We also examined the many studies, reports, and research analyses regarding cable that have been prepared by a wide range of organizations.

After reviewing the current range of views and research, as well as conducting its own studies, the Committee has set out its conclusions and recommendations on the major policy issues regarding cable. These recommendations do not represent a master plan to create a fully operable, nationwide cable system, but rather a broad policy approach for integrating a new technology into our country's mass communications media.

In recommending the policies and types of regulation to govern cable during the foreseeable future, we attempted to forecast only about ten years into the future; we were concerned both literally and figuratively with "1984." Prediction is a perilous task in the rapidly changing communications field; and the chilling vision of "1984" can never be far from any group studying a new mass communications medium for an advanced technological society. We would rightly be held derelict in our duties if we took no steps to avoid the clear present and future dangers of government control of communications technology, which have been foreshadowed in the literary imagination.

The Committee has examined the growth of cable communications and the governmental response to it, and we have concluded that a new policy is needed (Chapter I). At the heart of the Committee's recommendations is a proposed policy that would separate control of the cable medium from control of the messages on it. The goal of this policy is to assure the development of cable as a communications medium open to all, free of both excessive concentrations of private power and undue government control (Chapter II). Our specific recommendations (Chapter III) flow from this basic policy proposal; their thrust is that neither the local monopoly power of each cable system nor the government regulatory power necessary to prevent abuse of that private power should be extended to the programs or other content of cable's channels.

The Committee has concluded that programming, advertising, and other information and services on cable channels can be allowed to develop on a free and competitive basis, with no more regulatory power exercised over the content of this communications medium than is exercised over the print or film media. Of course some safeguards are needed for cable, as for other media, to protect individual privacy and prevent the unwanted intrusion into the home of offensive material.

The Committee recognized that many of our policy recommendations should not be implemented immediately (Chapter IV). These policies are best applied to an industry that is more developed and mature than today's cable television industry. There is, however, a need for broad agreement now on a long-range, national policy for cable. Without such a consensus, it would be difficult to take the steps necessary to move from current cable policies to the future policies that we recommend. Consequently, the Committee has recommended a transition period in which a new cable policy would evolve, and we have specified transition policies and procedures to assure that there would be a reasonably advanced and mature cable industry in existence when the long-term policies take effect.

Finally, we have proposed a Federally-supported program to demonstrate innovative public service uses of cable technology and to identify more precisely the technical and legal safeguards necessary to protect personal privacy in the use of cable (Chapter V). Some of the Committee members, however, were not in favor of this proposal. They expressed misgivings regarding both the need for such a demonstration program and the desirability of the Federal Government supporting an endeavor that they felt should best be left to private industry and local governments. While their concerns were shared in varying degrees by the entire Committee, a majority of the members concluded that, on balance, such a program would be appropriate, as long as it stressed the preeminent roles of private industry and local governments and minimized ongoing Federal involvement.

The report concludes with a summary of the Committee's major, long-range policy recommendations and outlines the principal rights, obligations, and prohibitions created by such policies, as they affect cable operators, cable channel users, existing communications industries, and various levels of government.

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[1] The Committee was composed of Peter G. Peterson, Secretary of Commerce, who succeeded Maurice H. Stans; Elliot L. Richardson, Secretary of Health, Education and Welfare; George Romney, Secretary of Housing and Urban Development; plus Presidential advisers Herbert G. Klein, Leonard Garment, and Robert H. Finch. Clay T. Whitehead, Director of the Office of Telecommunications Policy, served as Chairman of the Committee, and his Office conducted the Committee's staff work.

# CHAPTER I

## THE DEVELOPMENT OF CABLE COMMUNICATIONS AND THE NEED FOR A NEW POLICY

> *"Cable offers countless Americans a chance to speak for themselves and among themselves in their own way, and a chance to share with one another their experiences, their opinions, their frustrations, and their hopes."*

There have been many names associated with the subject matter of this report — Cable TV, CATV, broadband distribution networks, coaxial communications, and others. The names reflect the multi-channel distribution capacity of coaxial cable technology and the services such technology makes possible. Recognizing that any name chosen will be awkward or incomplete until it finds its way into general usage, we have chosen for our report the most simple and most encompassing, if not the most descriptive, name: "cable."

Coaxial cable, however, is only one type of broadband communications technology. Others, such as multi-channel microwave, may become available soon, while still others, such as fiber optics and laser communications, are further down the road. However, the substance of this report is applicable to the electronic distribution functions of such technologies, rather than to coaxial cable alone. We believe that our policies are sufficiently broad and flexible to accommodate developments in the emerging communications technologies. The policies are, by design, not overly sensitive to the technology employed, since the potential for abusive monopoly control of multi-channel distribution systems are inherent in the technologies that we foresee being used for mass communications purposes.

In attempting to create a policy for cable and other multi-channel distribution systems, the Committee found that several technical and economic facts provided an indication of the potential opportunities and risks presented by their future development.

Cable has the technical potential to become a communications medium of abundant capacity, with an almost limitless number of channels capable of carrying virtually any kind of communications.[1] Cable can distribute information to all households, schools, and places of business in an area, or it can route it to specific locations upon electronic request. It can offer a two-way capability allowing users to signal their wishes back up the cable and thus select particular programming or other information, or order goods and services from among those offered.

Economically, two factors are relevant. First, the cost of providing a cable channel is relatively low and is likely to decrease as improving technology expands the number of usable channels and lowers the cost of electronic equipment the customer may use in conjunction with cable. Thus, the cost of communications capacity is likely to be a small component of the overall cost of producing and distributing television programming, or of many other information services that might be offered over cable. Second, the apparent economies of scale involved as the number of channels and customers increases on a cable system mean that, in any particular neighborhood or community, only one cable system is likely to be viable and efficient; thus, cable will be a natural monopoly in each locality.

The remainder of this Chapter is devoted to a review of cable development and regulation to the present and an examination of the need for a new public policy regarding cable communications.

### The Growth of Cable

The first cable systems were simply community antenna systems (CATV) built in the late 1940's to bring better television reception to isolated communities in mountainous parts of Pennsylvania and Oregon. In these early CATV systems, for a monthly fee, customers' homes would be linked by coaxial cable to a tall antenna which could receive signals from television broadcast stations.

The first cable operators were usually local businessmen, who encountered little regulation. The FCC chose to exercise no authority over cable, and most state governments took little notice of it. Local governments became the regulators during cable's first decade largely because CATV operators needed permission to use public property and rights of way to lay their cables. The nascent television broadcast industry also paid little attention to cable systems aside from vaguely endorsing them as a means of extending and increasing the size of their viewing audience.

Despite the limited number of channels CATV systems could transmit, this service spread rapidly throughout many small towns in this country. In 1952, there were some 70 cable systems with 14,000 customers, while 10 years later there were an estimated 800 systems and 850,000 customers.

The decade of the 1960's was a period of even greater growth for cable. New technology increased the potential channel capacity of cable systems to 20 or more channels by the end of the decade. A number of cable systems were not only providing improved reception of nearby broadcast stations, but were also "importing" additional broadcast signals via microwave links from television stations in distant cities. Dozens of systems also began to offer some form of locally originated programming, often by transmitting pictures of news service or stock market ticker tape machines, time and weather information, and local advertisements.

Now, cable is no longer simply CATV. It is no longer simply a conduit for television distribution to the home. And it is no longer a "cottage industry." From its origins as a predominately rural and small town industry, cable is now beginning to come to some larger cities. It has grown to an industry composed of over 3000 systems in 1973, connecting almost 8 million households and continuing to grow at a rate of more than ten per cent per year.

The attitudes of the investment community toward cable have fluctuated widely in recent years. Currently, cable is facing a slow-down in the rate of investment flowing to construction of new systems in major cities, in part due to tight money markets and in part to investor disenchantment in reaction to over-optimistic views of cable profitability and growth.

The actual prospects for cable growth, however, have not fluctuated appreciably. In fact, research and development are producing lower-cost distribution methods and equipment for specialized home use of cable programming and other information services. It is reasonable to expect that cable's recent growth trends will continue or even accelerate.

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[1] In this report, a "channel" means the communications capacity for the equivalent of one standard television signal (6 MHz). This communications capacity may be used, whole or sub-divided, for distributing audio, data, single frame, facsimile, and other types of information, as well as a television signal. Thus, several "channels" of various kinds of communications might be distributed over one equivalent television channel.

Thus, cable is on the verge of becoming a new medium of communications in its own right, a vehicle for a wide variety of new services, and big business.

### Cable Regulation and the Need for a New Policy

The changes in cable technology and in the economic and social importance of cable should have been accompanied by changes in the public policy that govern its regulation. Yet, the regulators' perception of the cable medium has lagged far behind its evolving reality.

Federal regulation of cable is presently based upon the Communications Act of 1934, which deals with technologies that can accommodate only a limited number of signals. Lacking Congressional guidance and uncertain of its authority, the FCC at first denied that it had jurisdiction over cable. Through the late 1950's and early 1960's the Commission maintained this position, but in 1959 and 1966, it sought legislation expressly conferring such jurisdiction. During this same period, the Commission gradually moved to regulate cable indirectly by exercising its unquestioned authority over the other communications services that cable was using. The FCC began by placing restrictions on cable systems that were served by the microwave facilities of telephone companies and other communication common carriers. By 1966, the FCC had asserted broad regulatory authority over all cable systems, principally with respect to retransmission of television broadcast signals, and, in effect, froze cable growth in the nation's top 100 television markets. In 1968 the Supreme Court upheld the FCC's action as "reasonably ancillary" to the Commission's power to regulate television broadcasting.[2]

The FCC extended its jurisdiction over cable in March, 1972, when it issued rules that dealt not only with the retransmission of television broadcast signals, but also governed access to, and use of, nonbroadcast cable channels. At the same time, the FCC established technical standards and divided regulatory jurisdiction between the Federal and local levels of government. Cable regulation under the FCC's current rules is discussed in the Appendix to this report.

The legal basis for the FCC's broadening of its authority over cable beyond retransmission of broadcast signals was narrowly upheld by the Supreme Court in June, 1972, in a case challenging the FCC's authority to require cable operators to originate programs. The deciding vote in the 5-4 decision was cast by Chief Justice Burger who stated in his concurring opinion that:

> "Candor requires acknowledgment ... that the Commission's position strains the outer limits of even the open-ended and pervasive jurisdiction that has evolved by decisions of the Commission and the courts."

The Chief Justice added:

> "The almost explosive development of CATV suggests the need of a comprehensive reexamination of the statutory scheme as it relates to this new development, so that the basic policies are considered by Congress and not left entirely to the Commission and the courts."[3]

Presumably the FCC could continue this process of step-by-step rulemaking for cable under court interpretations of its existing authority but, as Chief Justice Burger noted, the jurisdiction of the FCC to regulate cable derives from a very limited foundation in the Communications Act of 1934, which created the national policy for broadcasting's use of the public airwaves. That policy was designed for a scarcity of outlets, but cable needs a policy designed for a communications medium of abundance and diversity.

If we do not create a new public policy for cable, it seems clear that cable will continue to develop and be regulated in the policy mold created for broadcasting. To some extent, this choice already is being made by the FCC, almost by default, since neither the Congress nor the Executive Branch has devised an alternative policy. In the absence of an alternative policy view, cable is regarded simply as an extension of, and a supplement to, the broadcast television industry. It is treated as a secondary service, albeit one that could engulf the primary broadcast service if cable's many channels are used to their full capacity. The perception of cable's multi-channel capacity as a threat to broadcasting could retard cable growth and even limit full use of all its capacity in order to protect broadcasting's financial viability.

But cable is not merely an extension or improvement of broadcast television. It has the potential to become an important and entirely new communications medium, open and available to all. The Committee has concluded, however, that cable may never become what it can become if it continues to be constrained by the policy of the Communications Act.

### The Need for Federal Action

The new public policy that is needed for cable communications must be created through a conscious and deliberate effort which will anticipate both the risks and opportunities of cable development.

We are approaching what has been characterized as a "post-industrial" society in which knowledge and information will be major factors in economic enterprise as well as in personal growth and satisfaction. In the past, the expansion and application of any new technology was often encouraged without particular concern for its future impact. Many Americans have accepted technological change almost as a good in itself. While our enthusiasm for technological change has been almost without bounds, in earlier times there was more room to compensate for error. If somehow technology went awry in one place or at one time, correctives could be applied in a different place or time.

But the era of haphazard technological development is drawing to a close. We can no longer permit technological innovation to "just happen," and then attempt to "regulate away" the adverse effects. This is especially true of a communications technology such as cable, which involves the delivery and exchange of knowledge and information. Because we have a legal and social system that fosters, and is dependent upon, a free flow of information so that a well-informed citizenry can guide its own destiny, the question of the relationship between the private communications media and the government is, in many ways, the ultimate issue in a free society. If the achievement of a new relationship between government and the private cable medium is not anticipated but left to chance, the free flow of diverse information and ideas that is protected by the Constitution could be endangered. This is the most important reason for a clear and far-sighted policy for cable technology on the Federal level: the overriding national interest in freedom of expression.

There is also another reason, less philosophical, but very important. Cable is not only a medium of expression, it is an industry — an employer of labor and capital, a producer of goods and services, and a contributor to the overall productivity of our economy. Cable is an industry which is closely linked to several major national industries including electronic data processing, telephone, television and radio broadcasting, the motion picture and music industries, and communications satellites. Although each cable system is a local enterprise, it distributes television signals in interstate commerce. Because of these characteristics, cable requires a consistent and coherent national policy.

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[2] United States v. Southwestern Cable Co., 392 U.S. 157 (1968).

[3] United States v. Midwest Video Corp., 406 U.S. 649, 675-76 (1972).

Recognition of the need for a national policy, however, must not preclude an appreciation of the important and often diverse local interests in the development and performance of cable systems. Localism plays as important a role in our system of mass communications as it does in our system of government. Cable can fulfill its promise of providing a medium for a multitude of diverse voices serving both local and national purposes only as long as state and local governments are given a substantial role in determining the policies for cable communications services.

### The Nature of the Choice to be Made

Having concluded that a new policy is needed for cable communications, we felt it important to clarify the issues that underlie the policy choice to be made.

Many questions have been raised concerning the ultimate implications of cable for society. Will people use all the services that full development of cable promises? Will they be able to absorb all the information cable can place at their fingertips or will it result in "information overload" and lead to increased confusion instead of increased knowledge? Will multiplying the choices available to us enhance the differences among us and result in social and political fragmentation? Will there be a "fractionalization" of audiences because of cable; and if so what will be its effects on social stability and on the economic viability of the broadcasting and cable industries? Will there be a loss of the sense of community and nationhood that has been enhanced by television broadcasting? Will there be an alienation of group from group, region from region; an unravelling of the social fabric and the development of a parochial outlook to replace a national and international outlook? Will a President be able to command all the major television channels to make an address to the nation? If not, how will this affect the political and governmental processes?

Every new medium of communications has posed similar questions, and we have no way of providing definitive answers to such questions in advance. We are certain, however, that the response to the challenges posed by new communications technologies must not be to stifle their growth because of fears about their effect. A democratic society must have faith in the good sense and resilience of its citizens and institutions in dealing with advancing technology. The extent to which we as individuals and as a society are able to benefit from the development of cable communications depends upon the wisdom and ingenuity displayed by private citizens, private industry, and governmental agencies.

We believe that cable development has the potential of creating an electronic medium of communications more diverse, more pluralistic, and more open, more like the print and film media, than our present broadcast system. It could provide minority groups, ethnic groups, the aged, the young, or people living in the same neighborhood an opportunity to express, and to see expressed, their own views. Yet it would also enable all of these groups to be exposed to the views of others, free of the homogeneity which characterizes contemporary television programming.

Cable offers countless Americans a chance to speak for themselves and among themselves in their own way, and a chance to share with one another their experiences, their opinions, their frustrations, and their hopes. Rather than increase the alienation of individual from individual and group from group, cable could combine the shared experience of national television with a type of active participation in the political and social process that was common in the days before urbanization eroded the opportunity for personal involvement in events that affected the community.

It is hazardous to attempt to predict cable's place in the future of communications. Even more than many other new technologies, cable has a host of zealous proponents who wax enthusiastic about a future in which cable will serve as an electronic genie ready to provide a rich variety of services to mankind. Others are doom-sayers who see cable as the instrument that will lead us inevitably into "1984," serving as the final extension of the industrial revolution which will make us the slaves of technology, leading lives devoid of freedom or privacy.

Still others see cable as having almost no impact. They predict it will struggle along as a minor supplement to broadcast television and will be shorn of all its glamour as soon as another new technology captures the imagination of a fickle constituency of academics, technocrats, newspaper feature writers, and assorted futurists.

The Committee did not attempt to assign a role for cable or choose a place for it in the future of communications in this country, nor have we treated it as a modern day Rosetta stone capable of unravelling the complex problems facing this society. We have simply concluded that cable has much to offer, and it should be given an opportunity to prove its worth to the American people in the marketplace of goods and services and in the marketplace of ideas. The proper role of government policy is to adopt, consciously and deliberately, a policy which insures that access to and use of cable's channel capacity are not constrained by any one force, whether it be the cable system operator's power over his channels or government regulation to deal with that power.

## CHAPTER II

## CABLE: A MEDIUM OF COMMUNICATIONS AVAILABLE TO ALL

> *"At the heart of the Committee's recommendations is a proposed policy that would separate control of the cable medium from control messages on it. The goal of this policy is to assure the development of cable as a communications medium open to all, free of both excessive concentrations of private power and undue government control."*

If cable is to become a constructive force in our national life, it must be open to all Americans. There must be relatively easy access at one end of the cable for those who wish to promote their ideas, state their views, or sell their goods and services; and at the other end, the consumer must have a meaningful freedom of choice to select from among a diverse range of cable programming and services. This unfettered flow of information is central to freedom of speech and freedom of the press which have been correctly described as the freedoms upon which all of our other rights depend. These freedoms are no less essential in the days of cable than in the days of soapboxes and pamphlets.

Our nation's theory of democratic government is based on the principle that the power to make decisions affecting the flow of information to and from the individual must be dispersed so that irresponsible, inequitable, or simply bad decisions will not have a pervasive, irreversible effect. In view of this principle, both governmental power and excessive concentrations of private economic power over the flow of information have been viewed as inimical to the achievement of a free and open society. The long-standing and deeply-felt opposition to concentrated private power over the media stems not simply from a belief that such power inevitably must be antithetical to this central principle of our Government. Although this reason continues to be valid, traditionally the excessive concentration of private power also has been opposed because it has often been used as the pretext for Government's own intrusive entry into the communications media. Given the technological and economic imperatives of cable, excessive concentrations of both private power and government power threaten the unfettered flow of diverse information and ideas in the cable medium.

The private power of the cable system operator is potentially great, because of the local monopoly characteristics of cable. Unless restrained in some manner, the system operator could control all of the channels on his cable system, which could constitute the bulk of the channels of electronic communications in a particular locale. There are two ways to restrain this power. One is a detailed governmental prescription of the affirmative obligations of the cable operator, requiring him to use his power in socially desirable ways. The second alternative is to limit the number of channels over which the cable operator has control of program content and to require that the bulk of channels be leased to others. By the first alternative, the Government would seek to regulate the *use* of private power; by the second, it would seek to limit its *extent*.

The first alternative was chosen for broadcasting — a policy prescribing the use of private power. Under this approach, the FCC enforces affirmative programming obligations upon the broadcaster to regulate exercise of his power over program content. While it is difficult to take issue with many of the goals underlying such government-imposed program requirements, they result in a regulatory framework in which the Government has the power to oversee the content of a medium of communications and expression. The existence of the power affects the relationship between the Government and the broadcast media, and creates the constant danger of unwarranted governmental influence or control over what people see and hear on television broadcast programming.

### The Separations Policy

The Committee has chosen the second alternative — a policy limiting the extent of private power, rather than asserting detailed regulatory control over the use of that power. We recommend adoption of a policy that would separate the ownership and control of cable distribution facilities, or the means of communications, from the ownership and control of the programming or other information services carried on the cable channels. By separating the distribution function in cable, which is a natural monopoly, from the programming functions, which can be highly competitive, the dangers of governmental intrusion and influence in programming can be avoided while the wide variety of competitors vying for the public's attention can be expected to produce a diversity of programming.

This policy would create an essentially neutral distribution medium and require control of the medium to be separated from control of the messages on it. The effects of private economic power on the means of distribution would cease to be a danger to the free flow of information, and there would be little need for the continued application, or threatened application, of Government power. The cable system operator would be obliged to deliver the messages of channel users with as little regard to content as the Postal Service has for the content of the print media. Ideas would have to win their influence in the marketplace, rather than requiring exposure through the regulatory process.

To place the separations policy in perspective, it is important to understand the functions of the mass media, and the present extent of Government regulation of the various mass media.

### The Functions of the Mass Media

Three basic kinds of functions are involved in the mass media: (1) the creation or compiling of information or entertainment; (2) the selection or editing of this information; and (3) the transmission or distribution of the information to the public.[1]

The owners of the various mass media differ markedly in the nature and extent of their involvement in each of these three functions. The information and entertainment that appears in newspapers, for example, is written primarily by reporters and writers who are employees of the newspaper, and this material is selected and edited by other employees. The newspaper is often printed on the paper's own presses and usually distributed throughout the metropolitan area in the newspaper's own trucks. It ultimately reaches the reading public through independent newsstands and retail stores or through delivery services, which may be owned by the newspaper. In magazine and book publishing, there is less of this "vertical integration"[8] of the media functions than in newspaper publishing. A book publishing company is often no more than a suite of offices from which representatives of the publishing company purchase manuscripts from writers, and then contract with printing companies to print them. The books are shipped through the mails and various express companies to a wide range of independent retailers, who sell the books to the reading public. While many magazines employ their own writers, they often contract out most of the functions involved in producing and distributing magazines. In television broadcasting, the essential functions of selection and transmission are, by law, performed by the same entity, the television station; and the station employees may create the programming as well.

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[1] The terms "media" and "mass media" are often used with great ambiguity. Generally, "medium" refers to the various technological means of producing or distributing information such as newspapers, magazines, radio broadcasting, or motion pictures. The term "media" usually refers to the industries or business that provide information or entertainment to the public. A medium can have mass availability, technologically and economically, but it may or may not collect a mass audience around a particular presentation. For example, television today is a mass medium in both senses, but hobby magazines collectively constitute a mass medium only in the sense of availability to a large audience; millions of copies of such magazines could be inexpensively printed and distributed, but far fewer would be bought and read.

### Government Regulation Common to All the Media

Despite the differences among the various mass media, Government control or regulation of media power is, in many respects, reasonably uniform.

To the extent that private power over a medium of mass communications takes the form of economic control, Government regulation is very little different from its regulation of any other business. For example, the antitrust laws apply to the media to prevent excessive concentration of economic or market power, just as they apply to the production and distribution of other goods and services. Indeed, to the extent that such laws and regulations prevent the assertion of significant private power over the dissemination of ideas, information, and entertainment, Government-imposed limits on the growth and exercise of private economic power also foster competition in the marketplace of ideas.

The communications media, however, because they are the media of expression, have another type of power that arises simply through the force or attractiveness of the ideas, information, or entertainment provided. It is here that Government power is and must be strictly constrained, lest it stifle the opportunities for the easy access and diversity of choice that the Government in a free society is supposed to foster. Government attempts to limit or suppress the flow of information have been regarded as particularly pernicious and are explicitly prohibited under the First Amendment's injunction that: "Congress shall make no law ... abridging the freedom of speech, or of the press ...."

But even within the framework provided by the deeply rooted legal and philosophical principles embodied within the First Amendment, the exercise of Government regulation of the media goes beyond the regulation of the media's economic power. Government, especially state and local governments in the exercise of their police powers, protects the individual's right to be free of unwarranted and unwanted intrusions. Therefore, the application of certain laws regarding obscenity, pornography, privacy, libel, slander, criminal incitement, and the like are deemed by the Supreme Court to be consistent with the First Amendment. Similarly, Government properly may regulate to some extent which means of communication may be used to disseminate which types of information. Because of the need to strike a reasonable balance among competing constitutional rights and considerations, each means of communication presents its own problems in defining the nature and the permissible scope of this type of Government regulation. For example, certain materials cannot be sent through the mail though they can be sold on newsstands; and a film that could be shown in a theater could result in criminal penalties if broadcast on television.

### Government Regulation Unique to the Broadcast Media

The broadcast industry, in common with all the other mass media, is subject to Government limits on its economic power, and the exercise of Government "police power"-type regulation of its information content and its transmission function. It is only in one significant respect that Government regulation of broadcasting is vastly different from the ***laissez faire*** approach that the First Amendment requires for the other media of expression.

In broadcasting, Government power is used to shape and direct the content of programming toward various social ends by requiring, or indirectly coercing, the presentation of various types of information and programming in the name of the public interest. Such aspects of broadcast regulation as the encouragement of certain types of programs by means of the license renewal process, the concept of broadcaster responsibility for all information disseminated over the airwaves, the equal time requirement for political candidates, and the Fairness Doctrine requiring "balance" in the discussion of public issues, have no counterparts in the nonbroadcast media. No Government agency directs a documentary film producer to present all sides of a controversial issue, or a magazine publisher to devote "equal space" to all candidates for an elective office, or a newspaper to devote some of its space to children's features or stories about minority group problems.

It is only in the broadcast media that the First Amendment has been interpreted to permit governmental efforts to foster the expression of certain ideas or information by intruding upon the creation, selection, and editing functions of the private media owners. Why this difference? The answer turns upon the unique power of the broadcaster in the marketplace of ideas.

The dominant characteristic of the broadcast media, especially television, has been the scarcity of usable frequencies or channels. This scarcity has facilitated an economic concentration in the broadcast industry that, because of the governmental role in assigning frequencies for use by the industry, is in effect a Government-conferred monopoly of broadcast outlets. In conferring this benefit upon broadcasters, the Congress has also decreed that broadcasters, by law, may control and must exercise responsibility for both the transmission and the programming functions of their stations. This combination of "vertical integration" of the media functions and the scarcity of outlets gives television broadcasters great power over the flow of entertainment and ideas. To offset such power, there was an inevitable expansion of Government regulatory power over the broadcast media; and it is not surprising that this regulation of the medium has carried over into regulation of the broadcaster's programming.

As a practical matter, to regulate the means of communication, apart from the programming, when the two are controlled by the same entity, requires powers of discipline, distinction, and restraint by Government that are perhaps unattainable. The regulation of programming tends to become an end in itself, rather than a means of achieving constitutional goals for the free flow of information. Government is driven to consider the practical effects of its regulation in terms of the effects on program content. What information and which speakers should be given preferential access; and, in the final analysis, what should the American public see and hear? These questions inevitably arise, not only when the Government chooses to control information through prior censorship, but also when it seeks to require the presentation of certain types of information through affirmative programming requirements.

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[8] A firm is said to be vertically integrated if it performs a series of successive functions in the production and distribution of its products. As an example, a petroleum firm that produces crude oil, transports it, refines it, and again distributes it to its own service stations would exhibit a high level of vertical integration. An enterprise is horizontally integrated if it operates a number of facilities that produce the same products. Examples are chain stores, and in the cable industry, the so-called multiple system owners who operate a number of geographically dispersed cable systems.

The end result of the fundamental policy choices made for broadcasting is that it is not a medium of communications open and available to all. The originators and producers of programming, advertisers, and individual citizens can gain access to the medium only through the broadcast industry or through a regulatory process that uses Government power to require the broadcasting of certain types of material. There is a very real danger that access to cable will be similarly constrained, unless an appropriate policy is chosen.

### The Print Media as a Model for Cable

Cable's multi-channel technology, together with the economic imperatives of a medium that is a natural monopoly, could lead to an even greater concentration of power than exists in broadcast television. When a single cable operator has the power to control the programming and information content of all the channels on his system, his monopoly power over the cable medium of expression is nearly absolute. Therefore, detailed and prescriptive regulation by Government is well on its way. Federal rules already require the dedication of certain channels on cable systems for such purposes as local government use; other rules apply the Fairness Doctrine, the equal time requirements, and other aspects of "public interest" program regulation to programs originated by the cable operator. If broadcast history is any guide, this program regulation will expand until access to cable is circumscribed by Government regulations.

The only way to avoid the broadcast regulatory model and allow cable to develop as a medium of communications open and available in a manner similar to the print or film media is to preclude the vertical integration of the programming and distribution functions in cable. In this way, the cable operator's distribution monopoly would not produce any concentration of power over free expression in the use of cable channels and would offer no pretext for Government control of programming or other information distributed by cable.

Thus, the separations policy would limit both private control over cable channels, and the Government regulation intended to offset that control. Under the separations policy, cable may be able to offer Americans the opportunity, diversity, and richness that characterize the print and film media in this country. Cable would offer unfettered access for those who wish to use it; channels to promote their ideas, state their views, or sell their goods and services, and the cable customer would have the freedom to pick and choose from among a diverse range of entertainment, information, and services.

# CHAPTER III

# LONG-RANGE POLICY RECOMMENDATIONS

> ***"We must guard against allowing regulation of the communications media to become an end in itself rather than a means of achieving the free flow of information and the free expression of ideas that are so vital to a democratic society."***

This Chapter sets forth the Committee's policy recommendations for a developed cable industry. Discussion of the recommendations is in three parts:

- an industry structure for the 1980's and beyond;
- an institutional and jurisdictional framework for cable regulation; and
- the relationship between the consumer and the cable.

As stated in Chapter II, the Committee attempted to anticipate and deal with the adverse effects of concentrated power in a vertically-integrated cable industry. We recognize, however, that full implementation of the policy is not appropriate for the developing cable industry of today, and, therefore, in Chapter IV the Committee recommends a transition period during which the full policy gradually would be implemented.

## Industry Structure: Distribution

*Recommendation 1:* Control of cable distribution facilities should be separated from control of programming and other services provided over the channels on those distribution facilities.

Under this recommendation, the principal business of the cable operators[1] would be to lease their channels, or sell time on those channels, to individuals or organizations that wish to offer programs or other services to the public.[2] The cable operator would be precluded from having any financial interest in, or relationship with, those leasing channels or time on his cable system. This would preclude common holdings in stock or other securities; loan arrangements; or any other interest in the channel user's enterprise.[3] If the cable system operator were to have such an interest in a channel user, he would have an economic incentive to favor the user in which he had a financial interest.

Simply requiring the system operator to treat all channel users on a non-discriminatory basis without prohibiting him from having an economic interest in a user would not be adequate to prevent anti-competitive behavior. The cable operator could, for example, charge artificially high, but still "non-discriminatory," rates to users of his channels and use the excess profits from his system ownership activities to subsidize his programming affiliate. This cross-subsidization would place the other channel users at a severe competitive disadvantage. Moreover, requiring "arms length" transactions between companies in the same corporate structure and prohibiting cross-subsidization present severe enforcement problems. Such problems typically lead federal or state enforcement agencies to impose rate-of-return, public utility-type regulation in an effort to control cross-subsidization and other anti-competitive abuses.

The Committee believes it is better to establish policies at the outset that deal with the causes of such adverse effects than to create the incentives for abuse and invite detailed Government regulation to deal with the effects.

*Recommendation 2:* Common ownership or control of cable systems, interconnection facilities, and program supply services should be the only form of cable "network" operation that should be prohibited.

It is likely that landline, terrestrial microwave, communications satellite systems, or other means will be used to interconnect cable systems on an *ad hoc* or long-term basis to create various national or regional networks for program distribution. Therefore, the Committee considered whether implementation of the separations principle must be extended beyond the local cable system itself to prevent the adverse effects of regional or national cable monopolies.

There are four functional entities that must be taken into account when applying the separations policy to such network operations: (1) the cable system operator; (2) the program retailer, who uses channels on local cable systems to offer programs to the subscribers; (3) the program supplier or producer, who provides programs to the retailer; and (4) the interconnection facility operator, who provides intersystem transmission capacity to connect one or more channels on several cable systems. Naturally, there may be overlaps among these entities. The cable system operator may be a multiple system operator who offers channels for lease on his many systems to a single program retailer. Moreover, there will be instances in which the program retailer and the program supplier are one and the same.

In one form of networking, the program retailer would lease channels, or buy time, on a number of local cable systems and on interconnection facilities, in order to reach a large number of geographically dispersed viewers. This type of networking would pose no threat to the public interest unless a single program retailer controlled a major portion of the available local cable system or interconnection capacity or entered into anti-competitive agreements with the operators of these facilities. Such instances of abuse can and should be dealt with under the antitrust laws, and there is no reason to prohibit networking of this type.

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[1] The cable operator is the person or entity holding the cable franchise or effectively controlling, through ownership or other arrangements, the operation of the cable system in the geographical area covered by the cable franchise. The cable "system" consists of the facilities used for "head-end" receive-transmit, switching, storage and control functions, facilities used for local distribution of signals, subscriber "taps," and related equipment and functions. We recommend, however, that the separation policy not apply to those limited capacity cable systems whose operators do no more than (1) retransmit the signals of television and radio broadcast stations that are defined by the FCC as "local" to the cable system's franchise area, and (2) provide "weather scan" or teleprinter-type information service on no more than one or two standard television channels.

[2] Even if the cable system owner does not control the content on all channels, he will still have an incentive to restrict access to his system by others if he controls and profits from a significant proportion of the channels, thereby defeating the purpose of the separations principle. It would, however, be consistent with this principle to allow the system operator to continue to have control over the channels used for retransmission of the local and distant television broadcast signals authorized under the FCC's cable television rules effective on March 31, 1972 (*i.e.*, all local and "significantly viewed" stations, plus the number of distant signals allowed on the basis of market size of the cable system's community), as well as control over the channels used for retransmission of radio signals authorized by the FCC. Program content of such channels is, of course, under control of the broadcast stations that originate the signals retransmitted by the cable operator. It also would not be inconsistent with the separations principle to allow the system operator to have program control over one or two additional channels. Of course, the policy would not preclude the presentation of a program produced by a firm in the same corporate structure as the cable system owner, as long as the channel lessee is independent of both the cable system and the program producer.

[3] This requirement would not preclude the system operator from having variable rates for channel leasing, as long as there is no discrimination among comparable channel uses or users (see Recommendation 9).

A second form of networking would involve the common ownership or control of local cable systems and interconnection facilities by a single multiple system operator. This, too, would pose no competitive threat to programming competition, as long as there is non-discriminatory access to cable channels and competitive availability of interconnection facilities.

The only form of networking that necessarily raises concerns sufficient to warrant its prohibition is the common ownership or control of cable systems, interconnection facilities, *and* program supply services. In these circumstances, program retailers, who are the pivotal point in the competitive supply of services to the viewers, would be caught in such a cable network's vise, making realistic competition impossible.

The common ownership of any other combination of functions, except cable ownership and program retailing, requires no special prohibition. Application of the antitrust laws should be sufficient to police possible abuses arising from other forms of joint ownership.

> ***Recommendation 3.*** There should be no restrictions on either cross-media ownership or multiple ownership of cable systems.

We recognize the potential dangers in allowing newspaper publishers or broadcasters to own cable facilities. Common ownership of media that are nominally competitive in the same markets may limit the range of ideas discussed and reduce the competition for advertising revenues and, in some cases, for audiences.

However, in the long-run, cable development could significantly alter the competitive relationships among the broadcast and print media and the cable industry. It would not constitute economic protectionism to give some consideration to those industries, especially television broadcasting, that would bear the brunt of technological innovation and competition from a successful cable industry. Broadcasters and publishers should have an opportunity to own or invest in cable systems in the communities they serve without being required to divest themselves of their present media holdings in those markets. Although broadcast stations would thus be allowed to a limited extent to engage in both program origination and cable operation in the same community, they would still be bound by all the restrictions on program control placed on cable operators.[4] There would, of course, be no prohibition against broadcasters or newspaper publishers owning cable systems outside the markets they already serve with these other media outlets.

It is reasonable to expect that most broadcasters and publishers would prefer to offer programming on cable channels that they lease rather than to own cable systems, and that should be allowed. On balance, the separations policy, with its assurance of access by all channel users, considerably lessens any potential harm which may arise from the cross-media ownership of cable systems. Therefore, no special restrictions on such cross-ownership appear to be necessary. Excessive concentrations of cross-media ownership would, however, be prohibited by normal operation of the antitrust laws, as would excessive concentration of control over broadcast-newspaper-cable channel content.

The Committee also considered the question of limits on the number of cable systems any one firm may control or the number of customers it may serve. The present trend towards increased concentration of ownership by "multiple system owners" would present serious problems if cable operators were allowed to control the use or content on all or most of their channels. Although the separations policy would significantly lessen those dangers, some anti-competitive dangers and the risk of technological stagnation presented by large-scale multiple system ownership would remain and should be dealt with by rigorous enforcement of the antitrust laws. However, such enforcement should be tempered by the usual "infant industry" considerations that have generally been found to be in the public interest with respect to developing new industries.

As a final matter affecting ownership of cable systems, the Committee considered the appropriateness of municipal ownership. We concluded that, while there was no need to prohibit such ownership by law, it would be unwise for municipalities to function as cable operators. For the foreseeable future, cable system ownership will be a capital-intensive enterprise that may well be subject to rapid technological change and associated financial risks. As long as private entrepreneurs are willing to do so, it is almost certainly an unsound allocation of tax dollars for municipalities to underwrite such ventures. Moreover, with a financial interest in the entity being regulated, it would be inappropriate for a local authority to function simultaneously as the "regulator" and operator of the cable system.

> *Recommendation 4.* Telephone common carriers should not control or operate cable systems in the same areas in which they provide common carrier services.

Cable systems share some of the characteristics of existing common carrier telephone systems. Both provide direct electronic connections between the subscriber and a central office; thus, both are capable of identifying and serving individual customer needs. Although most existing cable systems provide only one-way distribution of conventional television programming, the systems could also provide subscribers with a capability for signaling back up the cable to order particular programming or other information services.

Similarly, telephone networks intended to carry "two-way switched voice communications" have the potential to carry other one-way and two-way information services, although they cannot provide television or certain data services with present voice communications technology.

Unless limited in some way, widespread expansion by telephone companies into the cable business could stifle the development of competitive cable communications service. The local telephone companies' franchise arrangements and rights-of-way, their established marketing and operating organizations, and the opportunities they have for cross-subsidization from existing monopoly services could work to obstruct cable development, as could the heavy capital needs of telephone companies to extend and improve telephone service. Moreover, the size, vertical integration, and long-distance interconnection role of the nationwide Bell System, if extended to cable communications, could make it very difficult to maintain any realistic competition in communications.

The Committee has concluded, therefore, that the present FCC rule, which prohibits telephone companies from owning or controlling cable systems within their telephone service areas, should be retained. Telephone companies should, however, be allowed to continue to offer cable system operators transmission facilities for local distribution under the type of "lease back" arrangement that is currently in use.[5] Moreover, the carriers should provide cable operators with nondiscriminatory access to the carriers' poles, conduits, and other rights of way.

While telephone companies should be precluded from control of cable systems, they should be allowed to compete with cable systems in offering communications capacity for such services. After the cable industry is fully developed, there are likely to be a range of communications and information services that could use either cable or telephone systems. It will, therefore, be important for cable franchising authorities and utility commissions to make certain that the cable system, with its local monopoly of broadband distribution facilities, and the telephone company, with its monopoly over switched public telephone service, can compete fairly with each other and with others, without cross-subsidization or other anticompetitive practices.

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[4] Their position would be little different from the cable operator who was permitted to originate or control programming on one or two channels. However, the television broadcaster's over-the-air channel would be counted as one of the one or two cable channels on which the system operator can originate or control programming.

[5] This would not include operation of cable system "head ends," switching or other functions not associated with actual signal transmission.

### Industry Structure: Programming

> *Recommendation 5:* The development of new programming and other information services that can be offered over cable should not be impeded by government-established barriers to the consumers' opportunity to purchase those services.

At present, the range of information and entertainment available in television is quite limited. In many instances, the viewer in prime time may choose from among only three network programs, one educational television program, and perhaps one more program, which may well be a network rerun, offered by a local station not affiliated with a network. Because most of these programs are designed to attract as large an audience as possible, they are often geared to the lowest common denominator of viewers' interest.[6] There are few opportunities for the viewer to see programs of special interest or emphasis even though that "special" interest may appeal to millions of people over the course of a week or a month. Moreover, the limited number of broadcast television outlets reduces television's utility to advertisers who wish to reach only a particular segment of the mass audience. The high cost of the relatively scarce TV broadcast advertising time makes it uneconomic for such advertisers to purchase commercial time.

With cable, the quality and diversity of advertiser-supported programming can be expected to be greater than it is now with television broadcasting. Cable's larger number of channels means advertising time will not be as costly as it is in television broadcasting, and this alone could attract more advertisers. Advertisers could also avoid the need to pay for exposure to audiences they have no interest in reaching and could support on a regular basis new types of programs appealing to limited audiences.

While increasing the overall magnitude of advertiser-support of cable programming is important to both the viewers and the advertisers, full opportunity for the viewer to express the intensity of his program preferences, and to satisfy those preferences, can be assured only if the consumer also is able to make direct payments for television programming, as he does for magazines, books, and records.

The Committee recognizes that there are some valid concerns regarding the growth of subscriber-supported programming or "pay-TV." It is argued that some people may not be able to afford to purchase information or entertainment in the quantity they may desire. This is true; just as it is true that some people cannot now afford to buy as many books, magazines, newspapers, or records as they might like. But the creators of programs and other information services should not be prohibited from selling to anyone but broadcasters and advertisers; to do so would deny to the public many services and benefits obtainable in no other way. Especially in the constitutionally protected media, the problem of poverty should not be dealt with by governmental restrictions of the range of choices open to consumers. Moreover, from the standpoint of the poor, pay cable may be regarded realistically not as a more expensive form of television, but as a cheaper form of motion picture theater, sports arena, or concert stage entertainment. They may be able to purchase more of this type of entertainment programming over cable than they could otherwise afford.

Another frequently voiced concern is that some of the programs presently supported by advertisers may be withdrawn from "free" television to be sold instead directly to viewers. The FCC now has rules forbidding direct sale to viewers of certain types of sports programs, feature films, and other entertainment programming to prevent this program "siphoning." Of course, viewers already pay indirectly for advertiser-supported television since the costs of advertising are reflected in the products they purchase. Nevertheless, if programs once financed by advertisers must in the future be paid for directly by viewers, there will be a measure of discontent, which makes the issue both emotionally and politically charged.

Television broadcasters have already sounded the alarm in the press and in the Congress, arguing that program siphoning by "pay cable" will exacerbate the audience fractionization that they expect cable's abundance of channels to produce even without such programming. They maintain that cable's competition for the viewing audience will diminish the total advertising revenues now flowing to broadcast television and sharply reduce the profitability of their business. They claim that their profits are used to underwrite news and public affairs programs and to produce costly, high-quality entertainment programs, all of which would be sharply cut back in response to cable's competition for programs and audience.

This line of argument assumes that news and public affairs programs, as well as high-quality entertainment programs, cannot be self-sustaining through advertiser support or a combination of advertiser and subscriber support. This assumption is questionable. There is no doubt that the networks and individual television stations perform a valuable public service in their information programs. If it is true that no other entity is capable of matching the broadcast networks' scale of national and international news coverage, there will continue to be advertiser and subscriber dollars available to support the networks' news and documentaries. At the same time, cable's abundance of channels and lower programming costs appear likely to lead to the emergence of additional news and public affairs programmers offering specialized or in-depth analysis to supplement the general coverage.

More generally, there can be a mixed system of advertiser and subscriber support for television programs; the two means of support can coexist in the electronic media as they do in newspapers, magazines, and other print media.

We anticipate that the broadcast media will continue to find advertisers who wish to reach the largest possible audience and are willing to continue to support the present kinds of mass-appeal programming. At the same time, some national and local advertisers also will be attracted to the relatively smaller audiences that could be reached by sponsoring programs that appeal directly to those audiences. Cable would thus provide a wider choice of advertiser-supported programs than now exists. Moreover, other advertisers, who wish to reach audiences with special interests but cannot afford the high cost of broadcasting's limited advertising time, can be expected to underwrite "free" programs on cable.

By definition, most of the time most of the viewers will be watching general-appeal entertainment programs. This type of programming will continue to attract sufficient advertiser support, and people will pay only to see those programs that do not attract such support. Therefore, it is likely that most of the cable channels used for subscriber-supported programming will be devoted to special interest programs not available on advertiser-supported broadcast or cable channels or to repeating mass appeal programs at off-hours. This conclusion is important, not only for its implications of expanded consumer choice, but also for its promise of additional sources of revenue for the performing arts, public and private education, and for the television program production industry.

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[6] This is not meant to be a criticism of the intellectual or artistic quality of television programming, but simply a recognition of the effect upon programming of channel scarcity and the vertical integration of TV broadcasting. It is unlikely that very many Americans are reading Shakespeare's works at any given hour either, but our print media — unlike broadcast television — makes them economically available in such a fashion that we can read them when we choose to do so.

If the performing arts are to remain a vital part of our national life, they must be able to tap substantial new sources of funding. The expanded electronic box-office provided by subscriber-supported cable could be a major source of assistance. Public and private educational institutions could also derive additional revenues by offering vocational education, continuing and specialized education, and university extension courses over cable systems. Furthermore, the television program and motion picture production industries could be revitalized by subscriber-supported cable.

However, there may be a need to preclude the possibility that one type of mass audience appeal programming might shift to pay television. If there were no restraints, some popular professional sports programs might be "siphoned" from advertiser-supported television. In view of the congressional exemption of the professional sports leagues from the antitrust laws and the recent legislation barring the "free" television blackout of sold-out home games, sports programming stands on a different footing from all other entertainment programming on advertiser-supported television. Given the unique nexus between such programs and congressional policies, the Committee recommends that the FCC continue to apply some anti-siphoning restrictions concerning professional sports programs, until the Congress determines that they are no longer appropriate.

However, there is no need in the long-run for such restrictions on other forms of entertainment programming. The anticipated competition and flexibility in cable programming will make unnecessary and inappropriate any sweeping Government restrictions on the public's right to purchase a wide variety of information and entertainment services and on the originator's right to sell such services.

> *Recommendation 6.* The programming, information or other services provided over cable should not be subject to administrative regulation of content, nor should the prices of such services be regulated by any governmental authority.

Administrative regulation of broadcast programs has been sanctioned by the Supreme Court on the grounds that it assists in achievement of First Amendment goals under conditions of vertical integration and a scarcity of broadcast frequencies. But with no use of the public airwaves, with a large number of channels, and with implementation of the separations policy, there is no need to resort to governmentally-imposed approximations in the cable medium. Under such conditions, use of the Fairness Doctrine, the equal time rule, and other forms of program content control to regulate what the audience can or must see and hear would simply be an end in itself — an unconscionable choice for a free society.

The absence of administrative regulation of the content of cable communications, however, need not and should not remove local, state, and Federal sanctions on pornography, libel, criminal incitement, and the like. Indeed, the Committee believes that additional safeguards may be necessary. The Government can and should vary its regulation of the communications media according to their particular characteristics. Cable systems are analogous to the mails and broadcasting in that they serve the consumer in his home where, without adequate safeguards, children may have easy access to the material distributed over cable channels. But the postal laws appear to provide a better example than the broadcast laws of the type of additional safeguards that may be needed.

We recommend that the law provide safeguards to allow for selective control over reception of programs and other communications that are not desired by the recipient, enabling the individual to enforce his own standards of obscenity or violence without the need for extensive prior restraint. Such safeguards could include sanctions against the distribution of certain material to cable customers who have indicated they do not wish to receive it and requirements that the nature of certain programs be clearly identified, so that the subscriber can decide whether to accept them.

Cable technology permits individual choice in filtering out undesired communications through scrambling codes, locked channels, and other devices. Once such protective mechanisms are in place, more latitude could be allowed in programs presented over the cable medium than over the broadcast medium.

In addition to precluding administrative regulation of program content on cable channels, the Committee recommends that there be no regulation by any governmental authority of the prices charged to subscribers for information, programming, and other services by channel users. As discussed above, provision of programming and information services should be a highly competitive activity. There should be no need for any governmental authority to regulate the prices of such services. Moreover, Government regulation of such prices inevitably would lead to regulation of program and information content, since rate regulation would ultimately have a bearing on the nature, quantity, and quality of the services being sold. For similar reasons there should be no requirements that certain programs or information services be provided free of charge by channel users or cable operators.

> *Recommendation 7:* Incentives to create programming for cable should be fostered by full applicability of the copyright laws to cable channel users.

There will be a steady supply of programming for presentation on cable channels only if there is a full range of financial incentives for the creators of programs. Both equity and the incentives necessary for the free and competitive supply of programs require a system in which program retailers using cable channels negotiate and pay for the right to use programs and other copyrighted information. Individual or industry-wide negotiations for a license, or right, to use copyrighted material are the rule in all the other media and should be the rule in the cable industry.

As a matter of communications policy, rather than copyright policy, the program retailer who distributes television broadcast signals in addition to those provided by the cable operator should be subject to full copyright liability for such retransmissions. However, given the reasonable expectations created by current regulatory policy, the cable operator should be entitled to a non-negotiated, blanket license, conferred by statute, to cover his own retransmission of broadcast signals (see note 2, page 10).

## Institutional and Jurisdictional Framework for Cable Regulation

The preceding recommendations have dealt with the structure of the cable distribution and programming industries. This section sets forth the Committee's proposals for the requisite federal-state-local governmental relationships regarding cable regulation.

Since the general thrust of the Committee's recommendations involves far less detailed administrative regulation than has existed in broadcasting, we considered carefully the question of why cable systems have to be regulated at all. There are three reasons usually given: (1) a cable system is a natural monopoly in its service area, and as such, should be regulated to preclude abuses that competition would normally prevent; (2) virtually all cable systems are integral parts of the interstate distribution of programming and other information services, and some regulation of the transmission medium is necessary to assure system compatibility and interoperability; and (3) since cable systems compete with broadcast stations and could compete for some services with telephone companies, there should be parity of regulation among the competitors.

The third reason relies on a distorted notion of equity, which would justify pervasive and detailed regulation of cable simply for the benefit of cable's competitors. The first two reasons are valid, but they justify only a limited degree of regulation, quite different from the type that is usually considered in the telecommunications field.

Cable is an integral part of the interstate movement of electronic communications, and this relationship to interstate commerce provides adequate legal authority for the Federal Government to establish uniform conditions or minimum standards to which non-Federal action must conform.

However, the existence of Federal authority does not resolve the question of how to determine the most effective combination of national and local regulation. Federal authority could conceivably occupy the entire field, but this would be an unwise course, even if the Federal Government were somehow able to cope with the administrative burden of regulating thousands of cable systems across the country. State and local governments have an important interest in the construction and operation of cable systems, and they can best provide regulation responsive to local needs. Consequently, the Committee has concluded — as has virtually every other body that has grappled with this issue — that there must be a carefully structured dualism of governmental oversight.

> *Recommendation 8:* The Federal Government's authority over cable should be exercised initially to implement a national policy; thereafter, detailed Federal administrative supervision should be limited to setting certain technical standards for cable and applying anti-siphoning restrictions on professional sports programming.

The policy we recommend calls for use of Federal authority over cable solely as a means of achieving the national policy goals that we have identified. But Federal authority need not and should not intrude into all aspects of cable operations, as has happened in other fields of Federal regulation.

The Federal Government would exercise jurisdiction only over those aspects of cable operations that require uniform national treatment. The most important policies in this regard are the separations policy; the prohibitions on rate of return regulation of cable operators and on rate regulation of channel users; the anti-siphoning restrictions on pay cable presentations of professional sports programming; certain privacy safeguards; copyright liability; and other policies concerning industry structure in the cable transmission and programming fields.

Most of these policies do not require the day-to-day supervision of a Federal regulatory agency, but rather the uniform and consistent treatment that generally can be derived from enforcement in the Federal courts. For example, the Department of Justice and private parties could seek enforcement of those aspects of the policy that depend on the antitrust laws for their implementation (such as prevention of abusive cross-media and multiple-system ownership, anti-competitive joint use of interconnection facilities and cable systems, etc.), and those that involve constitutionally and legislatively protected rights (such as free speech, nondiscriminatory access to channels, and privacy).

The only aspects of cable regulation that appear to require continuing supervision by a Federal agency are enforcement of technical transmission or distribution standards and the sports anti-siphoning restrictions. The mandatory technical standards, however, should be limited strictly to those that are necessary to make cable systems interoperable and compatible with the equipment required to transmit and receive cable signals, as well as those necessary to protect individual privacy in cable communications (see page 13 of this Chapter). The Committee recommends that the function of establishing and enforcing technical standards be performed by the FCC, but this function should not be used as justification for cable licensing, rate regulation, or other control over industry operations or practices.[7]

> *Recommendation 9:* Franchising authorities should have the principal responsibility for the regulation of cable systems.

At present, overlapping local, state, and Federal jurisdiction over cable has led to the consideration or imposition of inappropriate forms of regulation. The FCC has dealt with some of these jurisdictional problems, but the comprehensive resolution of all of them will best be achieved through early enactment of Federal legislation to assure that non-Federal regulation is compatible with the overall national policy for cable. Federal legislation should establish the jurisdictional framework, but as a general rule, the non-Federal franchising authority should have the principal responsibility for regulation of cable systems. Use of the franchising process to exercise reasonable oversight of cable will avoid the continuing burden and bottlenecks of day-to-day supervision of system operations that could result from Federal or non-Federal regulation of cable by an administrative agency.

At present, the cable franchising function is performed by municipalities and other local governments. The Committee believes that the local levels of government should continue to exercise this vital function, since they are the authorities most closely attuned to local conditions and needs affecting cable system construction and operation. But it would not be appropriate for the Federal Government to assign responsibilities for governmental supervision of cable directly to municipalities. The decision regarding whether states or localities will perform franchising functions must be left to the states, although we strongly urge that the local governments retain such authority and functions.

This is not to say, however, that there should be no role for the states. The state governments are in the best position to assure that cable systems provide substantial public benefits and do not abuse their natural monopoly positions. States could provide overall guidance and assistance to local authorities in their franchising activities, and establish minimum requirements regarding safety of cable system construction and operation. If ultimately required, states could also oversee the reasonableness of customer connection charges and of channel leasing rates imposed by the cable operator and assure that cable systems and telephone companies compete fairly with each other and with other companies.

Within the regulatory structure we recommend, the franchising authorities would be subject to certain uniform conditions, standards, and guidelines intended to implement the national policy objectives for cable. The most important prohibitions and requirements to which state and local action must conform in order to achieve these objectives are as follows:

a. Prohibition on public utility-type rate-of-return regulation.

Rate-of-return regulation of the rates which cable operators charge channel users should not be imposed by any level of government unless there is a clearly defined need for it.[8] The need for such regulation may never arise, since the power of the operator to charge excessive rates for channel leasing would be held in check by the presence of competition from broadcast stations, telephone companies, or new technologies. More importantly, under the policy we have proposed, the cable operator would profit most in the long run by encouraging wider and more extensive use of his cable capacity. This should bring about an industry pattern of expanding cable capacity and facilities and lowering rates to stimulate increased usage. In any event, if cable operators were to evidence a pattern of limiting capacity and charging high rates, public utility regulation could then be imposed by the states. Such regulation would necessarily include both rate-of-return regulation and a requirement that the system add channel capacity upon reasonable demand. As with rate-of-return regulation, the expansion of capacity requirement should not be imposed until there is a clearly defined need for it.

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[7] We also recognize the responsibility of the FCC to set standards for spurious radiation from electronic equipment. However, these standards are not unique to cable.

[8] All regulation of rates and charges set by channel users for the provision of programming and other information services to their subscribers will, of course, be precluded.

b. Prohibition on grants of exclusive franchises.

There should be a prohibition on the grant of exclusive franchises for cable systems. While cable systems will be local monopolies because of technical and economic factors, there is no reason to erect legal barriers to competitive communications systems that may develop in the future or to other cable companies that could provide better service to the public than the cable system franchised initially. Even the possibility that the franchising authority might issue another franchise for the same area could act as a check upon the cable operator who was initially franchised.

c. Prohibition on use of franchise fees as general revenue raising devices.

Local authorities should not use the cable franchise as a means of raising general revenues, since revenue-raising franchise fees could dilute or remove the cable operators' incentives to expand services. Franchise fees, however, could be used to compensate the franchising authority for the costs of issuing and administering the franchise and for costs associated with the use of public rights-of-way. Moreover, the prohibition on revenue-raising franchise fees would not preclude local governments from imposing reasonable business taxes on the cable operator.

d. Prohibition on dedicated free channels.

Franchising authorities should be prohibited from requiring the dedication of special channels for governmental, instructional, and other special purposes. At present, FCC rules require that cable operators reserve one channel for educational use and one channel for local government use, and that these channels be made available without charge. Such specially designated and reserved channels served a purpose in the limited-channel, vertically-integrated environment of broadcast television. Such requirements are unnecessary in a cable industry operating under the separations principle, since educational and local government entities, along with everyone else, will have unfettered access to the cable system's channels. Moreover, such requirements inevitably invite franchising authorities to make value judgments and set priorities regarding the terms and conditions of using free channels. The interest of governmental, non-commercial, and nonprofit entities in low cost access to cable channels will be served adequately through the operation of the variable charge, leased-channel rate schedule discussed below.[9]

e. Requirement of adequate channel capacity.

To assure ample channel capacity for a variety of programming and other information service, the franchise should specify the number of channels that is considered to be adequate as a basic level of cable system capacity. The FCC presently requires that systems in the top 100 television markets be constructed with a minimum of 20 channels. Franchising authorities would be authorized to require channel capacity in excess of this minimum by negotiations with the prospective cable operator when the franchise is to be issued initially or reissued.

f. Requirement of non-discriminatory channel lease rates.

The franchise should require that the rates charged channel users by the system operator do not unreasonably discriminate among comparable channel uses and users. Disputes regarding the schedule of rates would be resolved by the courts, rather than the franchising authority.

There may be different rates charged for various times of the day, discounts for long-term or volume leasing of channel time or capacity, as well as different rates for various uses of the cable channels. For example, the highest unit rate for commercial use might be a percentage of the channel user's gross revenues received from subscriber-supported presentations of feature films, with flat rates charged for advertiser-supported programs; different rates could be used for utility company meter reading services or banking services.

The cable operator could also establish various pricing mechanisms for particular channel users. Channel users could be charged on the basis of each home subscribing to the particular program rather than charged a flat rate based upon the total number of homes connected to the cable system. In this way, special interest, public service, or instructional programmers could benefit from the economic base provided to the cable operator from channel users offering mass appeal programming.

In short, there are many ways that the cable operator could participate in the profitability of the programs offered by certain types of channel users, without undercutting the objectives of the separations policy. Furthermore, this would make possible lower rates for local governmental, educational, charitable, and other nonprofit organizations and civic groups.

g. Miscellaneous franchise provisions.

The jurisdictional framework for cable recommended by the Committee would allow franchising authorities to establish conditions dealing with the cable system operator's qualifications, construction timetables, extension of service to all portions of the franchise area, setting maximum limits on the rates charged by the system operator for cable installation and monthly service, handling of service complaints, and establishing other conditions not expressly prohibited by Federal policy.

## The Consumer and the Cable

In one sense, a separate discussion of relationships between consumers and cable systems should not be necessary. The policy direction we have chosen is intended to remove technological, economic, and legal barriers to the flow of information between the public and those who wish to provide programs or other information services. Theoretically, once the absence of those barriers is assured there should be no further need for Government to intrude upon relationships between the cable operators and channel users, or between channel users and subscribers. In practice, there are bound to be problems which will require some affirmative governmental effort to deal with them.

The Committee, therefore, recommends that steps be taken to prevent the invasion of individual privacy that could otherwise arise in some uses of cable. Additional action may also be needed to assure that basic cable or other broadband communications facilities are available to residents of outlying rural areas or to the poor. However, some of these actions will not be necessary for many years, until problems arise; or may not be needed at all, if no problems arise.

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[9] We note, however, the growing interest in public access, in which a cable channel is used as a "soap-box" to allow members of the general public to participate in a community dialogue. We believe that such a cable channel can serve important goals of free expression. It would not be inconsistent with the policy stated above to maintain in the present FCC requirement that the cable operator provide the use of one channel without charge for such public access purposes, as long as this requirement is imposed and administered by the franchising authority. However, we recommend against earmarking a portion of the cable franchise fee to subsidize the use of the public access channel, since other public and private funds can be used for this purpose.

*Recommendation 10.* There should be strong legal and technical safeguards to protect individual privacy in cable communications.

There has been justifiable concern over the possible invasions of privacy posed by the development of cable. For example, remote monitoring services, such as automatic meter reading, may be used by unauthorized persons for clandestine surveillance. Unauthorized persons could also misuse confidential, personal information conveyed by cable to data storage or processing centers. Furthermore, commercial enterprises, and perhaps local governments, would be able to keep track of every program a person watches or any information service he or she uses. This could cause a substantial "chilling" effect on the flow of information as well as a serious erosion of privacy. New technology could also make it possible to address selectively each cable subscriber and provide the means to inundate him with unwanted information.

The Committee considers the individual's ability to safeguard his personal privacy to be one of the most important goals of a free society. The law and the traditions of a society based on the initiative, responsibility and privacy of the individual require that technology serve, not erode, this goal.

Therefore, we recommend the adoption of legal safeguards to allow individual control over undesired communications and intrusions into the home. These safeguards could include sanctions against the distribution of material which the subscriber indicated he does not wish to receive or which he has not specifically requested. In addition to these safeguards, the constitutional and "common" law of privacy would also apply to cable and should be adapted and enforced by the courts. Finally, cable lends itself to use of technical safeguards, such as scrambling codes and locked channels. The FCC, in conjunction with other government agencies, should develop and implement technical standards and requirements necessary to afford added protection of privacy in cable communications.

*Recommendation 11.* Governmental authorities should assure that basic cable or other broadband communications are available to residents of rural areas and to the poor.

Even though a majority of the homes in the United States may be wired for cable and cable may be providing programming and other information services in addition to retransmission of broadcast signals, many residents of outlying rural areas may not have the option of subscribing to cable. While it may eventually become economical for cable operators to extend facilities to these areas, this may be an instance in which sole reliance on the free market incentives of cable operators may not be adequate to meet certain national policy objectives, such as the widespread availability of information.

If this becomes a significant problem in the future, the Government should take affirmative action to assure a basic level of broadband communications service for residents of outlying rural areas. We recommend that the Secretary of Housing and Urban Development and the Secretary of Agriculture be directed to follow the development of cable in rural areas and make recommendations for such Government action as they deem appropriate.

There has also been concern expressed regarding the availability of cable to the poor in urban and rural areas. Cable operators may attempt to delay or refuse to offer their service to areas where there is high proportion of poor households. To meet this difficulty, franchising authorities should require extension of service to all portions of the franchise areas. While this may be viewed by some as a subsidy of the poor by the rich, it is not a subsidy that is unusual or very burdensome, and it could avoid the emergence of a class of citizens cut off from what could well become the information mainstream of the future. Furthermore, many governmental services directed to the poor may be provided inexpensively and most effectively by cable. Vocational training, adult education, preschool instruction, and public health information are examples of services that might be provided over cable with state or, in some instances, Federal funding. We recommend that the Secretary of Health, Education and Welfare be directed to examine the feasibility and cost of using cable to assist in the delivery of such services, to make such information available to the state and local governments, and to include use of cable channel capacity in Federally-funded programs when appropriate (see Chapter V).

*Recommendation 12.* Participation by minority groups in cable system ownership, operation and programming should be facilitated.

The development of cable represents a unique opportunity for minority racial and ethnic groups to become actively involved in a new communications medium. Minority groups should have not only employment opportunities, but also full opportunity to participate in all aspects of cable ownership, operation, and programming.

The general policy for the structure and regulation of the cable industry that we recommend would facilitate participation by all segments of society in cable ownership or control of channel use. Moreover, the local franchising authority should ensure opportunities for minority ownership and control in cable systems and programming.

At the Federal level, the Equal Employment Opportunity Commission should devote special attention to the development of the cable industry to assure ample employment opportunities for minority group members. We also recommend that the Office of Minority Business Enterprise and the Small Business Administration of the Department of Commerce be directed to give high priority to cable and to propose any necessary special provisions, such as loan guarantees, to foster significant minority ownership or control of cable operations.

# CHAPTER IV

# A TRANSITION PERIOD

> *"The almost explosive development of CATV suggests the need of a comprehensive reexamination of the statutory scheme as it relates to this new development, so that the basic policies are considered by Congress and not left entirely to the Commission and the courts."*
>
> *– Chief Justice Warren E. Burger*

The policy recommendations in Chapter III are designed to deal with a developed cable industry. Such a nationwide cable medium, used for a wide variety of information and entertainment services, will be far different from the cable industry today, which is oriented primarily to the retransmission of broadcast television signals and is a relatively small part of the nation's communications media.

The next decade of cable's growth will require large quantities of long-term capital to finance construction of transmission facilities and more speculative risk capital to finance programming and other service ventures. Without the opportunity for adequate financial rewards, entrepreneurs will lack the necessary incentives either to construct systems in major cities, or to develop a wide range of services that use cable channels.

The Committee is aware that there are those in the cable industry and the financial community who fear that cable will not grow at all unless the cable operator is allowed to program his own channels in order to attract subscribers and maintain an adequate short-run cash flow. This concern rests on the questionable assumption that no one but the cable operator has sufficient incentives to develop the new programming that will be needed to attract subscribers in major cities. However unwarranted these fears may be, the immediate adoption of the separations policy could prompt many potential investors to avoid the cable industry, causing cable to fall prey to a self-fulfilling prophecy of failure.

Nonetheless, the Committee believes this is the proper time to agree upon a broad long-range public policy for cable communications which reflects agreement upon the core principle of separating the control of the cable distribution medium from control of the programs or other information distributed by cable. Such consensus is needed in order to indicate the framework in which the cable industry is to operate and to diminish the uncertainty that has troubled cable entrepreneurs, investors, regulators, and customers during the past decade.

However, in order to facilitate the orderly development of the cable industry, the Committee recommends a transition period during which there would be a phased, evolutionary implementation and application of the new cable policy by the Federal, state, and local levels of government. Taking such an approach, cable development in accord with the new policy need not await congressional action. Although some of the Committee's policy recommendations would best be implemented by enactment of legislation in the immediate future, there is much that the Executive Branch, the FCC, states, municipalities, and private groups can do to implement the Committee's policy recommendations during the transition period.

### Duration of the Transition Period

Specifying in advance the duration of the transition period on the basis of some measurement of the cable industry's maturity is a somewhat arbitrary but still necessary task. The Committee considered many possibilities, of which the two most likely were to:

(1) end the transition period at some predetermined future date, such as ten years after the initial aspects of the long-run policy are adopted; or

(2) end the transition period upon attainment of some objective criterion of "maturity;" such as the connection of some specific percentage of households to cable, either nationwide or in each franchise area.

There are several variations and combinations of these possibilities, and each has its strengths and weaknesses. Almost any approach that would end the transition at the same time nationwide could rather arbitrarily work hardships for particular cable operators or communities. Conversely, if the end of the transition period were based on homes connected to cable on a system-by-system basis, some cable operators might have an incentive to delay reaching the critical percentage and to forestall the separations policy through such tactics as charging excessive rates. This would be less of a problem if the overall nationwide rate of homes connected were used to measure the maturity of the cable industry.

On balance, the Committee believes that the most appropriate criterion to mark the end of the transition period is the point when the nationwide percentage of households connected to cable systems reaches about 50 per cent. As discussed below, however, the various franchising authorities should establish procedures for gradually loosening the operator's channel control in a manner most appropriate for each community, prior to achievement of the 50 per cent level nationwide. In this way, there would be ample local control over the rate at which each cable system became subject to the separations policy. Moreover, a viable national cable program supply industry could evolve in an orderly manner over the course of the transition period, rather than having to spring into existence full-blown at its end.

### Transition Period Provisions

In cable's early years, the potentially adverse effects of its natural monopoly characteristics will be minimal. Therefore, the primary purpose of the transition period is to postpone the full application of the separations policy, and the other long-range policy recommendations that flow from it, until the cable industry approaches maturity, when such policies will be both necessary and appropriate.

Accordingly, during the transition period, cable operators should be permitted to offer programming directly or to have financial or other interests in the programming and other services offered over their systems. At the end of the transition for the particular system, the cable operator would be required to certify to the franchising authority that the sales, trades, and other divestitute arrangements have been made to assure full compliance with the separations policy.

Before the full separations principle is in effect, cable operators may have economic incentives to limit channel capacity in order to enhance the value of the channels under their control. Therefore, to assure from the outset a reasonable number of channels available for lease to others, franchising authorities should be required by Federal policy to specify that cable systems make available for lease one equivalent channel for each channel used by the cable operator for program originations and for retransmission of broadcast signals. Moreover, the franchising authority should establish a pattern of gradual lessening of the cable operator's control of channels by increasing the proportion of channels to be leased to others over the course of the transition period.

Without the protection of the separations policy, the dangers inherent in allowing cross-media ownership (newspaper, magazines, broadcast stations) of cable systems will have to be dealt with in some other fashion. Therefore, certain types of cross-media ownership of cable systems should be prohibited until the end of the transition. The FCC's present cable rules prohibit the television broadcast networks from owning cable systems and preclude television broadcasters from owning such systems within their stations' service areas. These rules should remain in effect during the transition period, but there should be no divestitute required for existing cross-media ownership combinations. No other cross-ownership rules should be adopted.

The Committee also recommends against imposing multiple system ownership restrictions by the FCC during the transition. The dangers of excessive multiple ownership can be adequately controlled through application of the antitrust laws, tempered by the usual "infant industry" antitrust enforcement practices that have been found to be in the public interest.

Finally, during the transition period, there should be some limitations on the type of programming now available on advertiser-supported television that could be offered for a fee on cable systems. The FCC's present "anti-siphoning" rules are intended to preserve a basic level of advertiser-supported sports and entertainment programs on over-the-air television. While a mixed system of subscriber-support and advertiser-support for programs will provide the greatest choice and diversity for consumers and should not be restricted by government in the long run (see Chapter III, Recommendation 5), we recognize that some aspects of this policy are not appropriate for the transition period. For example, if some popular programs were "siphoned" from advertiser-supported TV while relatively few households were connected to cable, some viewers might be depriv[illegible] of a program on broadcast television before they had access [illegible] it on a cable channel.

As discussed above, many provisions of the transition period will end for some cable systems prior to the time when the number of homes connected to cable reaches 50 per cent nationwide, if the franchising authorities so determine. However, siphoning is a national concern and removal of restrictions should not be left to the discretion of franchising authorities. Therefore, we recommend that some restrictions on siphoning be administered by the FCC for the full transition period, and be made applicable against whomever is providing subscriber-supported programming during that period, whether it is the cable operator or a channel programmer not affiliated with the cable operator. However, the FCC's current "anti-siphoning" rules are quite complex. We do not endorse these particular rules, but we recommend that the FCC have the authority to adapt reasonable anti-siphoning provisions to the changing conditions in the broadcast, cable, and programming industries, selectively lessening the restrictiveness of the rules.

At the end of the transition period, there should be no siphoning restrictions except those applying to the "pay" presentation of professional sports events. As noted in Chapter III, the Committee feels that the Congress should determine the most appropriate time to lift such restrictions on professional sports programs, given the close relationship between such programs and congressional policies regarding the antitrust exemption for sports leagues and the "blacking-out" of sold-out home games.

There should be no additional administrative controls on program content on cable channels. Thus, the equal time provisions of the Communications Act, the Fairness Doctrine, and public service program requirements should not apply to programming originated on cable during the transition period or in the long run. It is essential from the outset that the use of the cable medium for distributing programs be free from administrative regulation of content.

### Evolutionary Implementation

The Committee believes that the long-range and transitional steps we recommend should evolve in a number of steps along two broad fronts: division of regulatory authority and adoption of long-range policy. While we strongly believe that the Congress should establish the principles of the new cable policy, virtually all of the steps described below could be taken by the FCC, either independently or in conjunction with franchising authorities, if the Congress fails to act.

a. Division of regulatory authority

The first step in the evolutionary plan, which should be taken immediately, is to divide regulatory authority over cable between the Federal and non-Federal levels, as discussed in Chapter III, Recommendations 8 and 9.

The FCC would keep in effect its present cable rules, except for removal of the requirements regarding: (1) mandatory program originations; (2) application of the Fairness Doctrine, equal time provisions, and similar kinds of program content requirements to cable program originations; (3) reservation of a public access channel, which would be left to franchise requirements; (4) specification of a basic level of channel capacity to be leased to others, which would also be left to franchise requirements; (5) designation of educational and local government channels; (6) expansion of channel capacity; and (7) specification of two-way channel capacity. Existing cross-media ownership of cable would be allowed to continue, but the FCC would maintain its present rules forbidding cable system ownership by television broadcast stations in their own markets and by television networks nationwide.

The FCC would also be prohibited from adopting multiple system ownership rules for cable and from imposing rate of return regulation on cable operators or any form of rate regulation on channel users. The common ownership or control of cable systems, interconnection facilities, and program supply services would be prohibited (Recommendation 2), as would the ownership of cable systems by telephone common carriers in their service areas (Recommendation 4). The FCC would adapt its present "anti-siphoning" restrictions on cable programming to reflect changing conditions in the broadcast, cable, and programming industries.

With respect to the franchising authorities, Recommendation 9 would be fully implemented. Thus, there would be prohibitions on rate-of-return regulation of cable operators; on rate or program regulation of channel users; on granting exclusive franchises; on use of franchise fees to raise general revenues; and on requirements for special-use, dedicated channels or free service. There would also be franchise requirements that lease rate schedules do not unreasonably discriminate among comparable channel uses or users, that system operators have adequate channel capacity, that system operators make available for lease to others at least one equivalent channel for every channel used by the operator for retransmission of broadcast signals or for program originations, and that one channel be made available for public access purposes. Furthermore, franchising authorities would have specific authority to control the rate of progress to full application of the separations policy by increasing the proportion of channels to be leased to others.

The Committee believes that prompt action by the Congress to divide regulatory authority over cable is especially desirable. The necessary consensus on a national cable policy could be reflected in a preamble to such legislation. While the preamble would not have the force of law, it would establish the separations principle as the goal for subsequent regulatory and legislative action by all levels of government. This would give the industry, the public, and governmental authorities a clear indication of where cable is headed and what the industry structure and government regulation is likely to be. This would facilitate planning by the cable industry and the investment community and greatly ease the subsequent evolution to a full separations policy.

b. Adoption of long-range policy

Implementation of the balance of the Committee's long-range policy recommendations and termination of the special transition provisions require the following actions effective at the end of the transition period:

1. Limitation of FCC authority to enforcement of technical standards and of restrictions on charging viewers for professional sports programs.

2. Removal of restrictions on joint ownership of television stations and cable systems in the same market and on television broadcast network ownership of cable systems.

3. Adoption of appropriate privacy safeguards.

4. Implementation of special provisions regarding availability of cable services to residents of rural areas and to the poor.

5. Requiring cable operators to divest themselves of activities not in compliance with the separations policy.

Ideally, these provisions would be enacted by the Congress to become effective at the end of the transition period. However, certain provisions, such as those regarding privacy and residents of rural areas and the poor, might become effective before the end of the transition period. If the Congress failed to act before the end of the transition period, the FCC, other government agencies, and the franchising authorities could still implement most of the long-range policy provisions.

# CHAPTER V

## A DEMONSTRATION PROGRAM

*"We have proposed a Federally supported program to demonstrate innovative public service uses of cable technology and to identify more precisely the technical and legal safeguards necessary to protect personal privacy in the use of cable."*

The Committee's basic concerns about the free flow of information led us to recommend a regulatory framework in which Government is neutral with respect to the nature and content of the messages distributed over the cable. Thus, the Government would not have regulatory mechanisms to require public interest uses of cable as it does in broadcasting. At the same time, the Committee recognized the potential of using cable for public services that traditionally are promoted or provided by Government agencies. We feel there is a need for the Government to make sure that this potential is fully explored and realized. We are concerned that relying solely on the commercial marketplace for the development of cable services may cause commercial applications to outstrip the development of public services. Unless cable's use for public services is thoroughly explored and developed early in cable's growth, the introduction of such services may be greatly delayed or thwarted.

Moreover, the Committee is convinced that legal and technical safeguards needed to protect individual privacy must be developed and evaluated before cable growth is so extensive and cable facilities and practices are so firmly entrenched that the appropriate safeguards cannot be adopted without major opposition, disruption, and expense.

Finally, there is a chicken and egg problem hampering the development of many valuable services that might be commercially viable. The demand for these services depends heavily on their availability, yet few potential suppliers are willing to accept the risk of developing new services without significant evidence of a market demand for them. Similarly, while each new cable service would require relatively expensive special facilities if offered alone, these services can be aggregated and the requisite facilities can be combined so that these costs can be shared, but no one has emerged to lead and coordinate such a joint effort.

The Committee believes the Federal Government has a responsibility to help identify the public services that can best be provided via cable communications and to evaluate appropriate privacy safeguards. The committee has concluded that the most effective way to achieve these objectives would be through a Federally-supported effort. Consequently, we recommend consideration of a systematic demonstration program involving Federal, state, and local government agencies, appropriate public and professional groups, and the cable and electronics manufacturing industries. The experience gained from this program would reduce the lead time needed to develop many desirable public service uses of cable and facilitate their widespread implementation with greater effectiveness and efficiency. The demonstration program would also make it possible for private users to test the feasibility of various new services at their own expense, offsetting some of the cost of testing public service applications.

### Description of the Proposed Demonstration Program

Although the Committee did not attempt to establish the precise characteristics of the demonstration program, it did consider the program's basic structure and overall objectives.

It is important that the demonstration program be carefully delimited in both geographic scope and duration in order to assure that the program does not constitute a widespread or continuing subsidy for the cable industry or a vehicle for government propagandizing over cable.

Governmental funds should be used only to support the purchase of advanced terminal equipment and to underwrite certain of the costs of the public service aspects of the demonstration. We expect that much of the system equipment and facilities, including the cable transmission system needed for the demonstration program, would be financed by the private sector or would consist of existing systems in a number of representative communities.

Participants in the program should include the Department of Health, Education and Welfare; the Department of Housing and Urban Development; the Environmental Protection Agency; and other Federal agencies which provide direct service to the public. State and local governments should be involved in the selection of demonstration services and sites, as well as in operational aspects of the program. And both private and public institutions should share in designing and providing services and in conducting related experiments.

Federal support for the program should run for no more than five years, with actual on-site demonstrations beginning as early as the second year. Systematic evaluation plans should be incorporated into each of the experimental efforts so that information will be available to guide the development of other experiments. All public and private institutions that participate in the demonstration program, including those who do so at their own expense by paying projected commercial rates for channel leasing and facilities, should be obliged to agree that all evaluation and experimental data will be made available to the public.

Some examples of types of service that have been suggested to the Committee as appropriate for the demonstration program are:

- Adult education courses and university extension instruction could be provided to individuals in their homes at times most convenient to them and in a manner tailored to their particular needs. These could include cable transmission of high school equivalency programs, vocational training, and college course work offered in conjunction with particular colleges and universities.
- A broad range of medical and public health information and services could be delivered to people in their homes, and channels could be used to enhance the professional training of doctors and para-medical personnel.
- State and local agencies could use the demonstration program to develop improved services for the collection, storage, and retrieval of a wide variety of local government information, including office hours, where-to-go for various services, and municipal code enforcement.
- Similarly, environmental agencies could experiment with cable in improving the effectiveness of their activities, including the monitoring, control and enforcement of air pollution standards, pollution health warnings for people with special sensitivities, and similar activities.
- Various businesses may wish to use facilities to test the feasibility of offering such services as use of the cable subscriber's home terminal to select and order goods from department store catalogues; to order tickets for transportation, entertainment, and cultural events; for home use of computer processing networks; for banking transactions; for files and record maintenance; and for electronic mail delivery.

# CHAPTER VI

## SUMMARY OUTLINE OF RECOMMENDATIONS

> *"The Committee has concluded that programming, advertising, and other information and services on cable channels can be allowed to develop on a free and competitive basis, with no more regulatory power exercised over the content of this communications medium than is exercised over the print or film media."*

The following sections A-E constitute a summary outline of the Committee's long-range recommendations (Chapter III) as they affect cable operators, channel users, telephone common carriers, the FCC, and the franchising authorities. The exceptions to those recommendations, which would apply during the transition period (Chapter IV), are summarized in section F.

A. Policies Affecting Cable System Operators

1. Operators should be REQUIRED to:

a. Offer their channels, or time on their channels, for lease to others for any lawful purpose, and without discrimination among comparable uses and users (pp. 10-13, 15),[1] with the exception of the channels used for retransmission of the broadcast signals authorized for carriage by the FCC's cable rules, plus one or two additional channels. The FCC's rules regarding broadcast signal carriage will apply to channels used for retransmission of the broadcast signals (note 2, p. 10).

b. Comply with Federal and franchising authority requirements to construct cable systems with adequate channel capacity (p. 15).

c. Comply with the minimum technical standards established for cable distribution by the FCC (p. 14).

d. Offer customers a selective means to control or prevent reception of programming or information services which the customer does not wish to receive, and to prevent interception of personal or confidential information distributed over cable (pp. 13-14).

2. Operators should be ALLOWED to:

a. Own and operate other media outlets such as newspapers, magazines, or broadcast stations or networks including those within the same market area as the cable system (p. 11).

3. Operators should be PROHIBITED from:

a. Having any financial or ownership interest in, or any control of, the production, selection, financing or marketing of the program or information services supplied by channel users leasing the operators' distribution facilities (p. 10); with the exception noted in section A.1.a.

b. Participating in the joint ownership or control of cable systems, interconnection facilities, and program supply services (pp. 10-11).

B. Policies Affecting Program Retailers and Other Channel Users

1. Channel users should be REQUIRED to:

a. Adhere to all applicable provisions of copyright laws and accept full liability for any program materials or information services they may supply (p. 13).

2. Channel users should be ALLOWED to:

a. Lease channels or obtain other distribution services from any cable system with which they have no financial relationship or other form of common interest or control — with the exception noted in section A.1.a. — and offer to the public any lawful program materials or information services via such system (pp. 10, 13).

b. Establish such charges as they consider appropriate for the programming or information services they supply, without regulation by Federal, state, or local authorities (p. 13).

c. Have legal recourse against any cable system operator: (1) who denies access or discriminates against the channel user by reason of the content of the user's message or the user's race, religion, nationality, or beliefs; or (2) who otherwise engages in practices that violate the requirement of non-discriminatory channel lease rates (p. 15).

3. Channel users should be PROHIBITED from:

a. Providing any information or taking any action in violation of relevant laws and statutes protecting privacy and governing dissemination of obscene, libelous, or otherwise illegal material, as well as material the cable customer has indicated he does not wish to receive (p. 13).

b. Requiring viewers to pay a fee for professional sports programming unless consistent with the FCC's anti-siphoning restrictions (p. 13).

C. Policies Affecting Telephone Common Carriers

1. Common carriers should be REQUIRED to:

a. Provide pole, conduit, or other right-of-way access to any franchised cable system operator at reasonable rates and without discrimination among users or uses (p. 11).

2. Common carriers should be ALLOWED to:

a. Offer local cable distribution service on a "lease-back" basis to any franchised cable system operator (p. 11).

b. Obtain franchises to operate as cable system operators outside of any area in which they have exclusive authority to provide telephone service (p. 11).

3. Common carriers should be PROHIBITED from:

a. Owning, controlling or operating any cable system within their telephone service areas, i.e., performing any function not associated with actual signal distribution, such as the operation of cable system "head-ends" used for information origination, reception, conversion, switching, or other processing functions (p. 11).

D. Policies Affecting the Federal Communications Commission (FCC)

1. FCC should be PERMITTED only to:

a. Establish minimum technical standards for cable distribution systems, only as needed to ensure compatibility, interoperability, privacy and security of cable systems (p. 14).

b. Require that cable systems be constructed with adequate channel capacity (p. 15).

c. Apply restrictions to the presentation for a fee of professional sports programs (pp. 13, 14).

2. FCC should NOT BE PERMITTED to:

a. Regulate in any way the information content of any services carried by cable system, including any regulations as to the balance or "fairness" of such information (p. 13).

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[1] All page references are to Chapter III, except where otherwise indicated

b. Require minimum channel capacity to be leased to others; designate special purpose channels; require expansion of channel capacity or construction of two-way capacity (Chapter IV, p. 18).

c. Regulate the rates or earnings of cable operators or channel users, or require any free service (p. 13).

d. Limit, by regulation or policy, the ownership of cable systems by broadcast stations or networks, or by newspapers, magazines, or other media outlets, or limit the number of cable systems to be owned by one firm or the number of customers to be served by one firm (p. 11).

E. Policies Affecting Franchising Authorities

1. Franchising authorities should be REQUIRED to

a. Award non-exclusive franchises for the use of public rights-of-way by cable systems, and collect franchise fees for such use to the extent the fees merely compensate for the costs of regulation or costs incurred in the use of the public rights-of-way (p. 15).

b. Require that the rates, terms, and conditions, for channel leasing, not unreasonably discriminate among comparable channel uses and users (p. 15).

c. Require that the cable operator make available one channel to be used for public access purposes (note 9, p. 15).

d. Require, through negotiations with prospective cable operators, that cable systems be constructed with adequate channel capacity (p. 15).

2. Franchising authorities should be PERMITTED to.

a. Set maximum limits on the rates or charges imposed on customers for cable installation (p. 15).

b. Establish franchising conditions dealing with the cable system operator's qualifications; construction timetables, extension of service to all portions of the franchise area; handling of service complaints; and other conditions not expressly forbidden to franchising authorities (p. 15.)

3. Franchising authorities should NOT BE PERMITTED to:

a. Regulate the information content of any service carried by a cable operator including any regulation as to the balance or "fairness" of such information (p. 13).

b. Award exclusive franchises for cable systems or require dedicated free channels for special purposes (p. 15).

c. Impose franchise fees on cable systems, when the primary purpose is to raise revenues (p. 15).

d. Regulate the rate of return or earnings of cable operators or the rates charged by program or information suppliers to their subscribers (pp. 14-15).

F. Transition Policies

The following exceptions to the long-range policy recommendations would apply during the transition period, which would end when 50 per cent of the nation's households were connected to cable systems (Chapter IV, p. 17).

1. Cable operators would be exempt from the prohibition on offering programming directly or having financial or other interests in the programming and other services offered over their systems (Chapter IV, p. 17).

2. Franchising authorities would have to require cable operators to:

a. Make available for lease to others at least one equivalent channel for every channel used by the cable operator for retransmission of broadcast signals or for program originations (Chapter IV, p. 18).

b. Establish a pattern of gradual lessening of the cable operator's control of channels by increasing the proportion of channels to be leased to others (Chapter IV, p. 18).

3. The Federal Communications Commission would continue to:

a. Prohibit future ownership of cable systems by television broadcast networks and by television broadcast stations in their station service areas (Chapter IV, p. 18).

b. Apply restrictions on the type of entertainment programming that can be offered to cable system customers for a fee and adapt such restrictions to changing conditions in the broadcast, cable, and programming industries (Chapter IV, p. 18).

## APPENDIX

### Current Regulatory Framework[1]

At first the cable television industry was regulated only by local authorities, whose requirements were designed primarily to assure that cables were installed in a manner consistent with construction and safety codes. These requirements were similar to those applied to other users of city streets and rights-of-way.

In 1965, the FCC issued its *First Report and Order* on cable television in which it asserted jurisdiction over microwave-linked cable systems. The following year, the *Second Report and Order* broadened FCC jurisdiction to include all cable systems, whether or not microwave links were used. This jurisdiction was tested in the courts and affirmed by the Supreme Court in 1968.[2]

The *Second Report and Order* also imposed restrictions on bringing "distant" television signals[3] into the top 100 markets. This constraint resulted in a virtual freeze on cable development in the nation's major urban and suburban centers, since cable operators believed that they would be unable to attract customers without offering distant signals in areas that already had good local broadcast TV reception.

In 1972, the Commission issued its *Third Report and Order*, together with comprehensive rules and regulations which are reprinted below,* lifting some of the distant signal restrictions and imposing a number of other requirements for major market cable systems. Although the rules permit expansion of cable into major markets, they also contain restraints which are designed, in the view of the FCC, to limit the competitive threat to the existing broadcast industry and to stimulate the use of cable for non-broadcast services.

The rules require that each newly franchised cable system obtain a "Certificate of Compliance" from the FCC before it may begin to carry broadcast television signals. This permits the Commission to determine whether the local franchising process, the franchise agreement, and the design of the cable system are in compliance with FCC requirements. The certification process also permits the applicant as well as the franchising authority to request waivers of the FCC's requirements when sufficient justification can be demonstrated. This provides a degree of flexibility in structuring a franchise to meet each community's individual objectives.

A two-tier regulatory system exists today with the FCC regulating the areas of:

- — Broadcast television and radio signal carriage
- — Program exclusivity
- — Channel capacity
- — Cablecasting
- — Operational procedures and requirements
- — Minimum franchise requirements

At the same time, local authorities may regulate such items as:

- — Selection of franchisee
- — Subscriber rates
- — Monitoring system's performance and compliance
- — Operation of municipal channels

In addition, there appears to be a third tier of regulation developing at the state level. Although only a few states have enacted cable regulations so far, it seems likely that eventually almost all will exert some degree of authority.

In terms of the specific uses to which a cable system may be put, the current FCC rules establish minimum requirements and require capacity for development of new services. For new major market systems, the rules require the following "designated" services:

1. *Retransmission service:* Mandatory carriage of local broadcast television stations and permissible carriage of distant broadcast stations up to defined limits (usually one or two).
2. *Local origination service:* At least one channel, under the control of the cable operator, devoted to local, non-automated programming.
3. *Public access service:* One free channel for the use of the general public on a non-discriminatory, first-come, first-served basis.
4. *Educational access service:* One channel, free for at least five years, reserved for use by local educational authorities.
5. *Government access service:* One channel, free for at least five years, reserved for government uses.
6. *Leased access service:* A number of channels available for lease to others who wish to provide new "undesignated" services via the cable.

In addition, the FCC's rules require a 20 channel minimum capacity. At least one channel must be available for non-broadcast use for each channel used to carry broadcast signals. Thus, if 12 broadcast signals are carried, the system must provide at least 24 channels.

With regard to two-way communication, the Commission has required only that the cable system be capable of eventually providing return "nonvoice" signals from the subscriber to the cable control center. No time schedule for implementing this capability, or for providing a wider range of two-way communication, is imposed.

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[1] Portions of this summary of cable regulation are reprinted from *The Uses of Cable Communications* with the permission of the Cable Television Information Center, The Urban Institute.

[2] United States v. Southwestern Cable Co., 392 U.S. 157 (1968).

[3] Distant television signals are those that originate too far away to be received by ordinary home antennas.

*Editor's Note: Full text of Third Report & Order and Rules & Regulations were reprinted by Television Digest Inc. Feb. 3, 1972. Therefore, they are not repeated below.

Attachment No. 5

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Article from The Village Voice describing private antitrust action brought by consumers against Time, Inc.

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THE monitor

The Village Voice **Bob Brewin** P.45 1/13/86

# People 1, Time and Cravath 0

Cable subscribers seeking redress against Manhattan Cable Television no longer live in legal limbo, thanks to a recent ruling in Manhattan federal court. In a precedent-setting decision, U.S. District Court judge Robert Sweet ruled that cable subscribers—not just the city—have the right to sue the company. His ruling laid the ground for what could become a long antitrust suit brought by New York Citizens on Cable TV, an ad hoc public interest group, against Manhattan Cable, its parent company, Time Inc., and Home Box Office, another Time subsidiary.

Bob Perry, an attorney for the tiny Media Law Clinic at New York Law School, which is handling the suit on a pro bono basis against a Time team from the giant Cravath, Swaine & Moore, said the ruling is the first he knows of in the country that gives third-party beneficiaries—the cable subscribers—the right to sue a cable company for failure to adhere to the terms of its contract. This decision could pave the way for future suits by disgruntled New York cable subscribers who feel the city has done little to enforce its contracts with Manhattan Cable (or the companies selected to wire the outer boroughs, which are behind in their promised construction schedules).

The December 18 decision was made in response to a motion by Time and MCTV to dismiss the suit, in which the citizens group, headed by Gary Kaskel, an Upper East Side videographer, alleged that the defendants engaged in monopolistic practices by offering subscribers services owned by Time (Home Box Office and Cinemax) but not unaffiliated services such as Showtime, owned by Viacom. Time sought to have the suit thrown out, claiming the citizens group lacked status as a third party to the cable contract. Judge Sweet, however, ruled that "the Franchise Agreement [between the city and MCTV] clearly manifests an intent to benefit the Committee's members in their status as cable subscribers. . . ."

## THE VIEWERS FIRST

Time also sought to have the suit dismissed on the grounds that any ruling requiring it to carry particular programming would be an abrogation of its First Amendment rights as a cable TV operator. Judge Sweet didn't buy this argument either, ruling that viewers and cable TV programmers have First Amendment rights that should be considered too. "Despite the intrusion on an operator's discretion . . . a nondiscriminatory injunction to open up the wires of MCTV to [non-affiliated programmers] would 'neither favor one group of speakers over another' nor regulate the content of speech. More importantly, an injunction would enable programmers to reach their intended audience, a result consistent with the preference of plaintiff cable subscribers. The Supreme Court has repeatedly admonished that the 'interest of viewers should be considered paramount in the First Amendment calculus.' "

A Manhattan Cable spokeswoman said the company intended to continue to defend its position, but what route that defense will take is not yet clear. According to Perry, Time and MCTV can either appeal Judge Sweet's ruling against summary dismissal to the second circuit court of Appeals ("and I think we'll win that too") or go to trial in district court. If the suit goes to trial it will kick off a discovery proceeding in the most controversial area of cable TV—the growing, vertically integrated nature of the business, in which companies that own the wire also own the programming. This suit could prove once and for all what cable's critics have contended all along: that big companies in the industry have a monopolistic hold on an entertainment medium that now goes into nearly 50 per cent of all American TV-owning homes.

On the local level, the suit will also shed needed light on Time Inc., the company that now controls the entire Manhattan cable TV market after a buyout of Group W last year (still not approved by the Board of Estimate) and a good portion of Queens through its American Cablevision subsidiary.

## MORE $$$ FOR TIME

The 400,000-plus Manhattan subscribers will also be sending Time Inc. more money now, because, as of December 29, cable TV became a federally deregulated industry—meaning operators can raise prices at will. As of January 1, MCTV's price for basic cable jumped from $12.95 to $13.95, and basic services in Group W went from $12.95 to $13.95. Prices for services such as HBO remain the same.

MCTV has dropped the Christian Broadcast Network from its lineup, replacing its pastiche of exhortations and westerns with the 24-hour CNN Headline News. And just in case two shopping channels (HSN1 and 2) aren't enough for people who want to but a lot of gold chains, MCTV will add yet another shopping channel, the Cable Value Network, on a partial basis sometime late this month.

And MCTV *still* can't find room for Showtime?

## WORLD TV FEST

Want to catch the U.S. premiere of an Ingmar Bergman film? Wondering what kind of stuff Radio Telefis Eirann is pumping out over the heather? Curious how Czech TV looks at WW II? How does Norwegian TV portray punk rockers?

All this will be spotlighted at the World Television Festival, which will be held at the Museum of Broadcasting (1 East 53rd Street, 752-4690), January 27 through February 28.

The festival will include a Bergman retrospective that features the first U.S. showing of *The Blessed Ones* (a/k/a *The Sign*), which Bergman directed for television from a play by Ulla Isaksson.

## SCAN LINES

. . . **Even Birds Do It:** Video, that is, now that the National Audubon Society has entered the field with its *Videoguide to the Birds of North America.* The three-volume series includes 450 different birds in both still and motion video and animated range maps as well as bird calls and sounds from the Cornell Laboratory of Ornithology. The series is available on video cassette and videodisc. . . . **Cheap 'Clowns':** CBS/Fox has included one of the funniest New York movies ever made, *A Thousand Clowns,* in its budget-priced ($29.95) Five Star Collection III, which went on sale January 5. Other titles in the 60-film package are *Star Wars, Exodus, The Verdict,* and a number of *Pink Panther* and James Bond films. . . . **Turner Hits 42nd Street:** Yep. He's done it again. Ted Turner has "colorized" the original Busby Berkley musical, 42nd Street, which will be released by CBS/Fox for Turner Entertainment in February. . . . ■

Attachment No. 6

## Anticompetitive Cable Channel Shifts

[From the Cincinnati Enquirer, November 29, 1986]

# WCET to ask subscribers to write, call Miami Valley

## Public station works to remain in cable's lineup

**BY IRENE WRIGHT**
The Cincinnati Enquirer

WCET-TV in Cincinnati will seek the support of subscribers to prevent Miami Valley Cable Television from dropping the public television station.

Postcards will be mailed Monday asking members and contributors to write to Miami Valley if they want to continue viewing Channel 48, said John Dominic, WCET vice president of marketing.

Cards will go to the station's 1,650 members in the Hamilton-Fairfield area and slightly fewer in the Middletown-Franklin area, Dominic said.

The impact of cancellation by Miami Valley "could be significant," Dominic said.

"Our entire membership is between 28,000 and 29,000, but that's just members, not all the folks who watch us," he said.

Miami Valley plans to drop eight channels in its north area and seven in its south area in December, and will add a comparable number of new channels, said Taylor G. Banks, Miami Valley's western Ohio manager for the parent company, Tele-Communications Inc. (TCI) of Denver. Rates will increase Jan. 1, he said.

Banks said subscribers will be asked to judge new programming for about 30 days.

"If we've misjudged the importance of channels taken off, we may have to look at that," he said.

Monthly rates will increase about 35%, from $9.92 to $13.40.

The Viacom cable television company in south Dayton had planned to drop WCET from its service, but decided not to after viewers wrote and called the company, Dominic said.

Each WCET member contributes an average $30 a year toward the station's estimated annual budget of $3.4 million, but being dropped by Miami Valley would mean more than just a loss of funds, Dominic said.

"There are a lot of intangibles," he said. "People who don't necessarily belong contribute to the annual spring auction. If they don't see us, how can they purchase things on the auction?"

Merchants in areas where viewers no longer have access to the channel might stop contributing to the auction, and that could halt educational programs provided to schools by the station, Dominic said.

Miami Valley officials say they are adding new channels to do away with duplicate channels. But Dominic said Channel 48 does not offer only duplicate programming.

"We purposely program differently than Dayton (Channel 14-16). We purchase a lot of movies and series that Dayton doesn't," he said.

It isn't as easy as cable officials say to pick up UHF channels, such as WCET, with rabbit-ear or regular antennae, Dominic added.

More than 2,000 TCI subscribers in other parts of the country were surveyed to come up with the new programming, Banks said. Representatives for area cities have said they want local surveys taken before programs are changed.

Jeff Heinrich, manager of the Miami Valley north service area, said the public protest "was not totally unexpected. But we didn't expect quite this big an outcry."

The 22,000 Miami Valley subscribers in the north area — which includes Middletown, Franklin and Carlisle — will lose Dayton Channels 2, 22 and 45, Cincinnati Channels 19, 48 and 64, and Indiana Channels 4 and 43. The 28,000 subscribers in the south area — which includes Hamilton and Fairfield — will lose Dayton Channels 2, 7 and 22, Cincinnati Channels 48 and 64, and Indiana Channels 4 and 43.

Channels to be added to both areas are Discovery, WGN of Chicago, Arts and Entertainment Network, EWTN and PTL religious channels, the weather channel (new for the south), Nickelodeon and American Movie Classics. An expansion of the Cable Value Network shopping channel also is planned.

Thurs., Nov. 27, 1986 Dayton Daily News and Journal Herald •3-A

# Metro Dayton

## Viacom to raise cable TV rates in Dayton

**By David E. Kepple
and Dave Daley**
STAFF WRITERS

While Dayton-area subscribers to Viacom Cablevision prepare for a rate increase, some cable television viewers in Warren and Butler counties face a rate increase and the loss of three Dayton television stations from the program menu.

And, in Franklin, at least, people are not happy about it.

"It's a public outcry," Franklin Mayor Bill Thomas said Wednesday. "I've talked to no one who really likes it."

In Dayton, word of a Viacom rate increase came Wednesday.

While the exact amount has not been set, Stan Smith, Viacom general manager, said subscribers can expect basic cable rates to increase to about $12.50 or $12.75 a month from the current $10.95.

That would represent more than a 14 percent increase and it will come shortly after the cable industry becomes completely deregulated Jan. 1. The Dayton City Commission has had some say over Viacom's rates, but that will end under a federal law approved two years ago.

"We're anticipating an increase sometime in the first quarter of 1987, probably February or March," Smith said. "The concern I've had in the past is that, since the basic rates have been regulated, they've been artificially low.

"The pay customer, the premium customer, the person who orders the extra service like HBO or Showtime, which were not regulated, were paying an inordinately high price.

"We're going to try to bring those two in order, so we may see a little bit more of an increase on the basic rates and possibly a reduction in the pay rates," he said.

At the least, Smith said pay-TV rates would not go up. HBO subscribers now pay $12.45 a month in addition to the $10.95 for basic service. Showtime customers pay an additional $10.95 a month.

"We brought two or three new services on in the past year," Smith said. "Like everybody else, labor is increasing a small percentage and our operating costs are going up. So it's going to have to cover those kinds of costs."

Last month, Continental Cablevision in Dayton's southern suburbs also announced rate increases effective Jan. 1, saying the rates reflect the company's increased costs for fees it pays for satellite programming.

Meanwhile in Franklin, Mayor Thomas said the controversy over the loss of Dayton stations will be discussed when the city council meets Monday night.

He also said city officials will seriously consider switching to another cable company in January, when the city's contract with the Middletown-based Miami Valley Cable Television Co. expires.

"If there's another cable company that's willing to come in, I'd certainly look at it," Thomas said. "I don't care if it's 'Johnny's TV' out of New Carlisle. I feel we've been wronged."

Lowell Lindon, general manager of Miami Valley Cable, was unavailable for comment Wednesday evening.

The company last week announced its plans to drop Dayton stations WDTN (Channel 2), WKEF (Channel 22) and WRGT (Channel 45), along with two independent channels and an educational channel from Cincinnati and an independent station from Indianapolis. The channels would be replaced by The Discovery Channel, WGN of Chicago, the Arts and Entertainment Network, EWTN (Catholic Cable Network), PTL Network, The Weather Channel, Nickelodeon and American Movie Classics.

Dayton's other commercial television station, WHIO (Channel 7), survived the purge and will remain available to subscribers.

The changes could come Monday. Miami Valley Cable serves Franklin, Middletown, Trenton, Monroe and Carlisle, among other communities.

The company also has announced its basic cable service rate is scheduled to climb from $9.92 to $13.40 per month beginning in January.

Thomas said city hall has been flooded with complaints from local subscribers.

"It's less of what we like to watch, and at more cost," said Thomas, who said he will cancel his cable subscription.

"I'm going back to my rabbit ears," he said.

# Cable firm to raise rates, change channels

**BY IRENE WRIGHT**
The Cincinnati Enquirer

Miami Valley cable television subscribers from Carlisle to Fairfield will be seeing some different channels and about a 35% rate increase in about a month.

Six channels, including three Dayton stations, will be dropped and replaced by seven other channels, among them Nickelodeon and American Movie Classics.

Monthly rates will jump from $9.92 a month to $13.40 a month starting Jan. 1, said Jeff Heinrich, manager of Miami Valley's south operation, which covers Hamilton, Fairfield, New Miami, Seven Mile, Trenton, and Millville, and St. Clair, Fairfield and Hanover townships.

"Costs of cable television was going up regardless of channel changes," he said. "The new channels are to improve the service we provide, and add more variety."

In the south area, customers will gain the following channels:

- ■ American Movie Classics, with movies devoted to 50 years of Hollywood's greatest films.
- ■ Discovery Channel, focusing on nature, technology, history and exploration.
- ■ Arts & Entertainment Network, cultural programming.
- ■ Nickelodeon, children and family programming.
- ■ WGN, superstation out of Chicago.
- ■ PTL and EWTN, religious stations.
- ■ Cable Value Network, home shopping that will be expanded to 24 hours a day.

Stations to be discontinued in the south area are:

- ■ Channels 2, 7, 22 out of Dayton.
- ■ Channel 64, Cincinnati.
- ■ Public television Channel 48 in Cincinnati.
- ■ Channel 4 from Indianapolis.

Slightly different channel changes will be made in the north operation, which includes Middletown, Monroe, Franklin and Carlisle, Heinrich said.

[From the Cincinnati Enquirer, November 27, 1986]

# Cable viewers see red

## Give satellite change a chance, firm says

**BY IRENE WRIGHT**
The Cincinnati Enquirer

Miami Valley Cable is getting static over its decision to replace some Dayton and Cincinnati stations with national satellite channels.

With the replacement and a rate increase, the cable system's 50,000 subscribers in Butler County and parts of Warren County are getting "less of what we want to see, and we're paying more for it." That's how Franklin Mayor William Thomas summarized the sentiment of subscribers he has heard from.

But a company spokesman thinks the dissident cable viewers will be won back once they view the new programs, due Dec. 1 or as soon as new equipment can be hooked up.

"We believe selection of satellite channels, compared to duplicated local network channels and some independent channels, is better programming for our subscribers," said Taylor G.

### Miami Valley cable picture

**What they lose**

*Here's what 22,000 Miami Valley Cable subscribers in the north area will lose:*

- Dayton Channels 2, 22, 45
- Cincinnati Channels 19, 48, 64
- Indiana Channels 4, 43

*Here's what 28,000 subscribers in the south area will lose:*

- Dayton Channels 2, 7, 22
- Cincinnati Channels 48, 64
- Indiana Channels 4, 43

**What they gain**

- Discovery Channel
- WGN, Chicago superstation
- Arts and Entertainment Network
- EWTN and PLT religious channels
- Weather Channel (new for south)
- Nickelodeon
- American Movie Classics
- Cable Value Network shopping channel expanded

Banks, Miami Valley's western Ohio manager for the parent company, Telecommunications Inc. (TCI) of Denver.

Banks asks subscribers for time, about 30 days, while new programming goes into effect.

"Then we'll know where we stand," he said. "If we've misjudged the importance of channels taken off, we may have to look at that."

Hamilton City Council, after hearing from half a dozen angry subscribers, voted Wednesday night to send a letter protesting the program changes. The board also resolved to start looking for another cable service, though the franchise won't expire until 1991.

Only about 13 subscribers have canceled service because of the lost channels, and a few others canceled because of higher fees, Banks said.

Monthly rates will increase about 35%, from $9.92 to $13.40 starting Jan. 1.

Subscribers in the north service area — Middletown, Franklin and Carlisle — are most vocal about losing nearby Dayton channels 2, 22 and 45. Those in the south area — which includes Fairfield and Hamilton — object to losing channels 48 and 64 out of Cincinnati, Banks said.

Michael Best, Fairfield first ward councilman, contributes to public television WCET (Channel 48), which he will no longer be able to view. He has heard the cries from viewers, too.

"People are concerned, not about the rate increase but about the changes," Best said. "Other companies can go double or better on the number of channels. I think therein lies the problem."

Residents who want to see the local channels they are losing can pick them up by using small rabbit-ear antennas, or with an A-B switch available at electronics stores for $5 to $7, Banks said.

Subscribers concerned about losing children's programming, sports and films will get extra benefits from the Nickelodeon, American Movie Classics and WGN channels, Banks said.

Starting Jan. 1, communities will have no voice in program or rate changes by cable television companies. Cable companies also will no longer have to carry every channel within a 50-mile radius, Banks said.

TCI surveyed 2,000 of its 6 million nationwide subscribers to come up with the new programming, but Hamilton, Fairfield and Franklin officials say they would like to have seen separate surveys in their cities.

"I don't think they're taking into consideration local programming and priorities people have," said Hal Shepherd, Hamilton assistant city manager. "Each community is unique."

Middletown City Manager William Burns is asking residents to write to him about what channels they want, and he will inform Miami Valley and city commissioners. But, he cautions, "We can't promise that we can meet everybody's demands."

BEST AVAILABLE COPY

C-2/Metro THE CINCINNATI ENQUIRER Friday, November 28, 1986

# Cable changes anger Hamilton customers

**BY JOHN R. CLARK**
The Cincinnati Enquirer

HAMILTON, Ohio — Butler County cable television subscribers are keeping their fingers crossed that they may have — just may have — convinced Miami Valley Cable Co. officials that they are unhappy with coming programming changes.

And a 35% rate increase proposed by the company isn't helping matters any.

Jeff Heinrich, Miami Valley Cable assistant manager, conceded Wednesday night after listening to complaints from Hamilton City Council and cable subscribers that the proposed changes "are not all set in stone."

"Changes can be made," he said.

Heinrich said Tele-Communications Inc., parent company of Miami Valley, wants to give cable subscribers the best programming possible. After a 30-day viewing period, comments will be sought from subscribers on the changes.

The programming changes — dropping Dayton channels 2, 22 and 45 and Cincinnati channels 48 and 64, and adding several others — are scheduled to take effect the first week in December, Heinrich said. The 35% rate increase, from a basic rate of $9.92 to $13.40 a month, with no charge for additional outlets, is to follow in January.

Heinrich's explanation, however, failed to appease members of Hamilton City Council, several of whom sharply criticized the company for proposing the changes without local input.

Councilman Adolf Olivas said that "it doesn't make sense to judge this market with 600 other markets across the nation" in deciding programming. Local opinions should have been sought before any changes were proposed, he said.

"Unfortunately, this council has no authority to dictate to the cable company what they can do," Olivas, an attorney, said. "That ability has been legislated away from us."

Councilwoman Joan Witt said discontinuing WCET public television Channel 48 "would be a great loss to us" and asked that the addresses of the local cable company and its parent company be announced so subscribers can contact the companies.

Mayor Gregory Jolivette noted that many Hamilton area residents are subscribers to Channel 48. He suggested that Cable Value Network, which offers items that can be bought by telephone, be taken off instead.

"We are trying to get people to buy locally," he said.

According to a Channel 48 spokesman, that station is aware of the proposed change and is preparing a protest.

One unhappy subscriber referred to the proposed changes as "cablegate" and told council, "You can put all the exclamation points you want behind the name Hamilton, but as long as you allow these things to happen — Chem-Dyne, Vancegate (the city's ongoing power purchase dispute with Vanceburg, Ky.) and now this — the exclamation point means nothing."

Heinrich said the changes were proposed first because the company "could not ask subscribers what they they think of channels they haven't seen." He said the company received 261 telephone calls at its office at 4117 Hamilton-Middletown Road regarding the changes.

Council unanimously approved a motion that an official letter of protest be sent to the cable company and its parent company advising company officials of the city's objections to both the proposed rate increase and programming changes.

A second motion also was approved unanimously directing the city administration to begin solicitation of new franchise proposals. Although the franchise with Miami Valley Cable does not expire until 1991, Olivas said, "it is not too early to be looking for new proposals."

A-2—MIDDLETOWN (Ohio) JOURNAL Sunday, November 23, 1986

# Cable subscribers offer thoughts on upcoming changes

**Miami Valley Cable subscribers may not be pleased with the company's decision to hike rates, drop several channels and add others according to an informal telephone survey conducted Saturday by The Journal.**

Of 15 subscribers contacted, one voiced support for the change and seven said they did not approve. Seven more did not know about the change or chose not to comment.

Customers expressed only mild discontent with the rate changes, but the main area of concern seemed to be the dropping of seven local channels.

"We're kind of unhappy with the changes because the reason we have the cable is for the channels they have that they are going to be taking off," said Terry Whitt, 3505 Vannest St.

"The minuses are all things that I look at and listen to," said Keith Rainey, 451 Doverdale Drive, Monroe. "I can't see much of anything on the plusses I want to look at."

Rainey said he is considering canceling his service and putting back up his motor-driven antenna.

"Here we are sitting half way between Cincinnati and Dayton ... (and that) should be a big plus for this company," said Rainey, adding Dayton has been virtually deleted from the company's programming.

"We will drop (the service) and get a satellite dish," said Debbie Altick, 8195 Meadowlark Drive, Franklin. She agreed that she and her husband primarily view the stations being dropped.

Sue Alberts, 2212 Superior Ave., said the changes wouldn't upset her and her husband enough to drop the company's service, but they were not happy especially with the dropping of channels 64 and 45.

R.D. Smallwood, 223 Park Ave., Franklin, cited, in particular the dropping of Channel 4 from Indianapolis. He said it provided good farm news.

"I believe we get a better selection of viewing on the channels that we're carrying now," he said.

Subscribers will lose: Channel 2, WDTN-TV, Dayton; Channel 22, WKEF-TV, Dayton; Channel 45, WRGT-TV, Dayton; Channel 48, WCET-TV, Dayton; Channel 19, WXIX-TV, Cincinnati; Channel 64, WIII-TV, Cincinnati; and Channel 4, WTTV-TV, Indianapolis.

Cable will add the Discovery Channel, WGN of Chicago, Arts and Entertainment Network, EWTN — Catholic Cable Network, PTL Network — religious, the weather channel, Nickelodian and American Movie Classics.

The changes will also include the raising the basic cable rate from $9.92 to $13.40 at the first of the year.

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*Channel Realignments*

# United Cable Eyes Plan To Bump Network Affils to Upper Channels; TCI Unit Will Cluster Independents

## United Calls Plan A Trial Balloon

By Peggy Ziegler

LOS ANGELES—In a bid to program cable channels in much the same way television stations program their broadcast hours, United Cable Television Corp., the nation's ninth largest cable operator, said last week it is developing plans for a company-wide channel realignment program that could move network affiliates and independent stations out of low bandwidth positions and into spots on the upper reaches of system lineups.

United chairman and chief executive officer Gene Schneider said the plan to move broadcasters is still just a tentative part of an overall plan to realign basic cable services on United systems. "We haven't come to a complete conclusion on this, but we think it's interesting to move some of these network stations around the dial," he said.

United marketing and programming vice president Nimrod Kovacs likened the new programming theory to shopping mall designs that encourage traffic past small stores by anchoring large-volume department stores at opposite ends of the mall. He said United hopes to increase viewership of basic cable services by putting them between repositioned network affiliates and independents. The realignment plan will roll out in United systems over the next year. United systems in Denver, CO; Abilene, TX; and Bellevue, NB, will be among the first to undergo channel lineup changes, he said.

If broadcasters occupy channel positions beyond the popular VHF 2-13 bandwidth, "there will be no more Siberia," Mr. Kovacs said, referring to the upper reaches of a cable system's channel lineup. Cable services get less viewership there than in the VHF band, where viewers are drawn by broadcast network fare and independents.

United didn't want to follow the lead of the Southern California Cable Marketing Council, which is planning a universal tier for Los Angeles area cable systems, with selected basic services joining broadcasters on the lower tier, because the plan is would move just four basic cable services to slots near the broadcast

*See United, page 39*

"Broadcasters will be moved and in some cases dropped. I'm sorry if they're pissed off. But we're not singling them out. TBS is out there, too. Goddamn it, it's my cable system, and I paid millions to build the plant. I get mad when they tell me how I can run my store."

— Barry Marshall, TCI West

## *TCI West Move Angers Indies*

By Linda Haugsted

SEATTLE—A top official of TCI West said last week that the regional cable operator is finalizing plans for a universal channel lineup for systems in five western states which will retain network broadcast affiliates on the lowest channels along with American Movie Classics, The Discovery Channel and The Disney Channel but will probably displace local independent broadcast stations in many systems.

Officials at other systems in Washington state said they will likely follow the TCI model.

Barry Marshall, divisional vice president and operating officer of TCI West, a unit of Tele-Communciations Inc., said broadcast network affiliates will remain in the VHF band because they are traditionally the most watched channels. Local broadcasters will remain in the lower band if their

*See TCI, page 39*

# United

Continued from page one

stations, Mr. Kovacs said. United has eight to 10 services it wants to place in better channel positions, including what Mr. Kovacs termed United "must-carries"—services in which United has an equity position, including The Discovery Channel, the Preview Network and Cable Value Network.

"It's the way (NBC Entertainment president) Brandon Tartikoff and other people at the networks look at programming," Mr. Kovacs said. Just as broadcasters program to provide strong lead-ins to certain shows, under the United plan, basic cable services would be positioned to take advantage of nearby strong broadcast signals to boost viewership, he said.

To reduce viewer confusion about the changes, United would put repositioned network affiliates in a channel position that included their original channel number, with channel 2, for example, becoming channel 12 or channel 22.

The changes will start in United's Denver system but will be modest there, since Mile Hi Cablevision, with which United shares an interconnect, has franchise provisions protecting broadcasters' channel positions. All network affiliates will retain their off-air channel numbers, but United will place USA Network, Cable Value Network, and ESPN in new positions in the lower tier, Mr. Kovacs said.

Plans in other systems could be more ambitious. "Our view of it is as long as you carefully communicate to consumers what you are doing and why are doing it, they don't really care if channel 4 is on channel 4," Mr. Kovacs said.

In Abilene, TX, a system that will be programmed under United's proposal, all three network affiliates are already in off-channel positions, and one station manager said he expected additional changes would make little difference to the station. "I'd have to see what their plan is before I react to it," said Ken Knox, station and sales manager for NBC affiliate KRBC-TV. "Chances are the effect would be minimal."KRBC, which broadcasts over channel 9, has been on channel 5 in United's Abilene system for many years, Mr. Knox said. With 16 cable systems in the area, KRBC has resorted to promoting only its call letters in its advertising. "Channel identification is virtually impossible," he said.

In Bellevue, NB, Omaha broadcast stations will remain on-channel, said system general manager Steve Shippers. "We want them to retain their channel identity," Mr. Shippers said of the broadcast stations. "When they say, "Watch KMTV-3, we want our subscribers to know where they are."

Mr. Kovacs said the roll-out of the plan will be gradual and done in co-operation with the wishes of the local United operators. "We will not dictate to the local systems," Mr. Kovacs said.

United was concerned enough about broadcasters' reaction to the plan to label it a "trial balloon," but Mr. Kovacs said, (Broadcasters' reaction) depends on how it's being done. The stations might bitch about it, but conceptually our job is to promote cable television, not broadcast television."

United has already faced fire for channel changes. Its recent move to bundle three UHF stations, including an NBC and ABC affilite, into one channel on the United cable system in Hartford, CT, drew fire from the Connecticut Consumer Council office and from the franchise's local advisory council.

But Mr. Kovacs said subscribers in Hartford didn't complain about the bundling of the three signals. "The broadcasters were the ones who complained," he said.

Other services that will be shifted at United Systems include MTV, USA Network, ESPN, CNN, and Headline News.

Mr. Schneider said realignment of broadcast signals would also help eliminate ingress, the signal disturbance caused by a strong broadcast signal interfering with its own cable signal. ☐

# TCI

Continued from page one

ratings justify it; otherwise they will be clustered in channels 20-30 with distant signals such as WTBS and WGN. Music and other topical services will also be clustered together. Ratings dictate that popular services such as ESPN and CNN should be in the VHF band, he said. Pay services will remain relatively unchanged.

"I view the future of the cable business, in 1987 and thereafter, as a retailer no different from J.C. Penney or a grocery store, with merchandise to sell, including premium services, remotes, et cetera. In the past there were too many fingers in the pie regarding how much we could charge and must-carry. Now we can make a business decision based on national research, and you can't always make everyone happy. Just like when a man with a 48-inch waist goes into a store, he's not going to be happy if you don't carry a 48-inch waist in pants," Mr. Marshall said.

"Broadcasters will be moved and in some cases dropped. I'm sorry if they're pissed off but we're not singling them out. TBS is out there, too. Goddamn it, it's my cable system and I paid millions to build the plant. I get mad when they tell me how I can run my store," he said.

Mr. Marshall said broadcasters are presently being formally notified of the cable company's plans. Some Washington state independents, however, are already aware of the impending shift from their traditional off-air placements and they are fuming.

"They never told us what they were planning, and as we got more information, the more shocked we became. They have no regard for their subscribers. They're just basing a decision on the bottom line . . . what's especially distressing is there is no logical manner to the move. We've heard we're to be on channel 25 in one system and channel 29 in the next," said Kevin Hale, general manager and vice president of KSTW-11 in Seattle. (Mr. Marshall said KSTW will be on 23 in all markets except those where the placement creates a technical problem. In those markets it will continue to be carried on Channel 11.)

Mr. Hale said the move of the cable operator will disrupt the viewing habits of 200,000 households in 14 cable systems.

"Ultimately, the viewers will suffer. I think they'll be very upset. We do one hour of local news. We'll be carrying 'Cheers,' 'Family Ties,' 'Night Court,' possibly 'Cosby,' (in syndication) and I think they'll be very upset if they can't find us," he added.

"We've spent a lot of money identifying ourselves with a number," added Roger Ottenbach, general manager of KCPQ-13 of Tacoma. "If they put us out at the end of the dial, (consumers) will have to tune through a lot to get through to us. The question is, will they? Maybe that's part of the reasoning behind putting us out there."

Mr. Ottenbach said a shift in the channel assignment could affect ratings because the families "out there filling out those diaries won't be able to find us, and ratings will determine what will be the bottom line," he said.

Broadcasters in Washington state said they will be meeting together with attorneys and representatives of the Association of Independent Television Stations Inc. to determine what options the broadcasters have to prevent or rescind a change of channel.

"This is a direct attack on independents. If we don't fight it, the affiliates could be next," Mr. Hale said.

Mr. Marshall said the channel lineup will be instituted in TCI West systems Jan. 1, hardware permitting.

Officals at TCI West's parent company could not be reached for comment last week on whether the TCI West lineup will be the pattern for other regional divisions of the nation's largest cable systems operator. ☐

[From the Multichannel News, September 8, 1986]

# Cable Operators Begin To Shuffle Channel Lineups

By Debbie Narrod

NEW YORK CITY—Cable operators around the country, now planning budgets for 1987, the first year cable rates will be wholly deregulated, are more and more looking to restructuring channel lineups so that satellite-delivered cable services take the low-numbered channel slots near or adjacent to local broadcast network affiliates.

Likely to lose those low-numbered slots and be pushed to upper channel spaces, according to a number of system operators, are UHF broadcast stations, duplicative network affiliates, alphanumeric services and access channels.

One of the first companies to begin this channel-shifting process was Heritage Communications, which months ago reconfigured lineups in Dallas and Des Moines and is now dedicated to making such changes "wherever the opportunity presents itself," said Jim Braun, program manager. Such changes are now being effected in other major Heritage systems, including south Texas and South Bend, IN, he added.

Heritage had identified what it called a "core four package" of cable services it would like to put on the V-band (channels 2-13) of systems: CNN, ESPN, MTV: Music Television and USA Network. Moving these services to lower-numbered channels and near broadcast affiliates, Mr. Braun said, will increase spot viewing of the services, leading to increased cable viewing overall and to an increased perception of value in cable by the subscriber.

The fact lower-numbered cable channels are more significantly viewed was proven in Dallas shortly after a lineup change was effected. The system, formerly owned by Warner Amex Cable Communications Co. and equipped with Warner's two-way interactive Qube equipment, was monitored by MTV to see how its viewership changed with the lineup switch.

Until mid-November last year, MTV was on channel 58 in Dallas; after the switch, MTV moved to channel 10, near the local ABC affiliate; no change in program package was made.

According to Steve Seidman, MTV vice president, research, MTV's viewership increased by one-third in December and by the same amount in January in the Dallas system. (The Qube equipment has since been replaced.)

"I think it's clearly a function of having moved closely to a highly used channel, the broadcast channels," said Mr. Seidman, who called the phenomenon a "rub-off effect." Cable subscribers, he continued, "spend a disproportionate amount of time around clustered channels . . . and it comes down to where a lot of usage comes down from the broadcast networks."

Another reason the operator sees for bringing basic cable services to lower-numbered channels is to encourage local ad sales, Mr. Braun noted: "It's a much easier sell when you can tell the advertiser it'll be adjacent to a broadcast station." Heritage Des Moines manager Ted Stewart agreed he'd gotten positive feedback from local advertisers, but he couldn't quantify how much of an increase his system achieved from the switch.

Mr. Braun, like other operators reached last week, downplayed how much of an effect programmers' incentives to be on lower channel numbers were playing in Heritage's efforts in the area, although he called the incentives "a worthwhile discount." He added, "We were doing this prior to the incentives."

ESPN and MTV have been most aggressive in pursuing low-band channel slots, operators said, with ESPN offering discounts for single-digit placement and with MTV viewing such placement as one in a number of factors leading to more favorable contract extensions. Other services, notably USA, said they had no intention of offering monetary incentives for placement although they advocate such switches to improve the customer's perception of cable's value and to boost local ad sales.

"This is a matter of choice between short-term dollars from services who buy positions versus the long-term benefits of customer satisfaction and retention," said USA senior vice president, affiliate relations Gil Faccio.

ESPN began studying channel placement more than a year ago, following a "gut feeling that it must have some impact" on viewing, according to Roger Williams, vice president, affiliate marketing. The sports network began doing its own analyses and then had A.C. Nielsen Co. run some statistics, as have other basic networks. Today, Mr. Williams said, several hundred systems have committed to moving ESPN to single-digit channels, with most of the changes coming from system rather than multiple systems operator level.

MTV Networks senior vice president and general manager, affiliate sales and marketing, John Reardon said while MTV had always pushed for advantageous channel placement, operators have lately been "taking a brand-new look at how lineups are arranged," a look he called especially important in view of price increases operators are expected to effect next year.

Mr. Reardon said he noticed this interest "came to a head at the Cable Television Administration & Marketing Society meeting in July.

"Viewers are habitually driven to watching shows around (the broadcast networks)," Mr. Reardon continued. "If the cable industry can increase viewership of cable product, then it could get better advertising revenues and enhance its perceived value as it changes price structures."

"We fundamentally believe the business we'll be in, in the next five years, is selling cable product," concurred Brian Roberts, Comcast Cable vice president of operations. By 1990 or 1992, he said, "We could be charging $20 for basic, and subscribers will want product worth that much."

That product, he said, should be cable product, "MTV and VH-1" more than independents, which he said had been proliferating since cable offered them distribution. "Shouldn't we give more, and good, shelf space to cable? Why have people trained to view UHF?" Mr. Roberts asked.

Comcast, according to president and chief executive officer Robert Clasen, has seven to eight basic services it would like to see on lower bandwidths, nearer broadcast affiliates. "You probably only need four broadcast stations below (channel) 13," Mr. Clasen said, adding, "We'd rather viewers migrate to cable."

To get such lineups, Comcast expects to drop former must-carries, depending on how the rules are finally structured, according to Mr. Clasen, who noted his systems had already axed 10-12 stations. Comcast is now reviewing channel lineups on all its systems as part of its budget process; Mr. Clasen said half to 70 percent of the operator's systems would have "significant" channel realignments in the coming year. "We view this as an opportunity to come back and resell the product," he stressed.

United Cable Television Corp. is also locking at system-by-system lineups, with an eye toward putting cable services "with the greatest potential" on the lower bandwidths and near broadcast affiliates, said Nimrod Kovacs, vice president of marketing. Services with potential, he said, are those with consumer appeal or those with possibilities for strong local ad sales. He said he believes a cable service moved to a lower-numbered channel could gain 50 percent in local ad sales, "if not double."

Mr. Kovacs said to make room for cable services on the lower bandwidth, UHF stations will likely be displaced and duplicative TV stations would be removed "where capacity is tight." United began considering such changes a year ago, he said, using studies from ESPN, United systems and local coincidentals.

In the early stages of research into V-band and broadcast channel adjacency for cable networks is American Cablesystems Corp., which assistant vice president, marketing, David Thaler said was also doing research system by system. American has also begun talking to other operators in its markets about configuring channel lineups the same throughout a market—the "fixed-channel" concept.

Boston is one of the markets where the talks have gone farthest, where 600,000-700,000 cable subscribers may be affected, said Mr. Thaler. Charles Townsend, Colony Communications president, said the game plan there would be to select four or five top cable channels and put them next to the broadcast channels. Mr. Townsend said the research he's seen on such restructuring "is tremendous," noting the proximity to broadcast stations rather than specific low-numbered channels seems to be most important.

Robert Williams, president of National Cable Advertising, was charged by the Boston-area operators to explore the fixed-channel ideal further and report back to the group.

He said last week his study of the channel lineups of the 23 systems and 40-some headends in the area had shown that getting fixed numbers for four or five basic services might be unreasonable in Boston, but added there may be a way to choose one such service. Smaller markets, he added, probably could go to fixed channel lineups. Still, he said he now believes "if a particular system can create a cluster of highly viewed channels, it may be more important than fixed channels."

Mr. Williams said area broadcasters have been showing interest in the fixed-channel idea, with some offering to fund new converter cards for operators and others looking at other innovative ways to get involved.

The Boston operators are expected to meet to discuss the issue further next month.

Cox Cable is another of the big operators examining the V-band channel issue, according to director of programming services Terry Freedman, who noted the decentralized company doesn't dictate to its operators what their lineups should be. "One dilemma we have, is while we understand the benefits viewership-wise in being on a low V channel, we wonder what type of service should be there," he said.

Putting an ad-supported channel on the lower numbers, he said, may increase viewership, but the benefit in local ad sales is questionable as operators aren't yet selling on costs per thousand. On the other hand, perhaps operators should put services with lower viewer awareness (Mr. Freedman cited Lifetime and Arts & Entertainment Network) on the lower bandwidth to better convince subscribers of cable's value. Most subscribers, he pointed out, know what ESPN and MTV are.

"We don't know which way we'll go," Mr. Freedman said, adding, "We don't think the decision should be based on who gives what" for placement.

Cox Cable Spokane reconfigured its channel lineup early this summer, resulting in a channel 2-13 roster of four broadcast stations, a governmental access channel and the rest basic cable services: Headline News, USA, ESPN, CNN, MTV, WTBS and Nickelodeon. Higher-numbered channels were grouped in genres, such as information, family or religious; * * *

[From the Seattle PI, December 4, 1986]

# Cable TV company's plans could leave viewers' heads SPINNING

By Susan Paynter
P-I Television Critic

The Davids of local independent television felt they won a round yesterday in Seattle City Council Chambers in their battle with the Goliath of the cable TV industry.

But the postponement of a takeover of Group W Cable by Tele-Communications Inc. (TCI), the nation's largest cable company, may be just a stay of execution for Channels 11, 12 and 13, which, under TCI's proposal, would soon go spinning off their designated VHF spots on the dials of Group W cable customers and into the upper reaches of the less accessible and less profitable UHF range. Channels 2-13 VHF (very high frequency) have the strongest signals, are the most easily accessible on standard TV sets and are the stations most often watched. Naturally, advertisers favor those stations.

Under TCI's plan, KSTW (Channel 11) would be shifted to Channel 23, KCPQ (Channel 13) would appear on Channel 24, and Bellingham's KVOS (Channel 12) would be on Channel 32. KTPS (Channel 28), Tacoma's public-TV station, would be dropped entirely and stands to lose the 34 percent of its subscribers who live in the Seattle area.

Several of the most desirable lower-numbered spots would be given to programming favored by the cable conglomerate. The Cable News Network would be on Channel 3, American Movie Classics (a new movie service) would be on Channel 6, Lifetime cable would be on Channel 8, ESPN sports would be on Channel 10, Disney would be on Channel 12, Nickelodeon would be on Channel 13, The Weather Channel would be on Channel 14 and a cable shopping program would be on Channel 15.

TCI spokesman Curtis Speck, general manager of Seattle's Group W, admitted that TCI owns stock in CNN, American Movie Classics, The Weather Channel, the shopping service, Discovery Channel (which would be on Channel 33) and the Black Entertainment Network (which would share space with other shows on Channel 34).

Group W customers would also see their bills jump 17.5 percent by January under the TCI plan, and there seems to be no hope for stopping that increase since, under the Supreme Court-ordered deregulation of the cable industry effective Dec. 29, cable companies no longer need the approval of city and county councils to raise their rates, even if those rate hikes exceed the 5 percent ceiling formerly in effect.

In fact, it was unclear yesterday just how many teeth are still left in local ordinances governing cable TV operations. Technically, councils still grant cable franchises and the transfers of those franchises from one firm to another (in this instance, from Group W to TCI), but City Councilman Paul Kraable said a council can't deny such a transfer unless the applicant lacks the finances, technical capability or industry experience to deliver cable services to customers.

New "must carry" rules were issued by the Federal Communications Commission last Friday governing which local stations cable outfits must make room for, and the council moved to postpone its ruling on the TCI takeover until its members have read those new rules. Chairman Norm Rice delayed the TCI vote until a special Dec. 17 session, saying he also wants more time to study just how much authority city councils still have over cable TV when it comes to the public interest. He also wants time to study other issues that were raised by angry independents at yesterday's meeting.

But time is the one resource TCI does not have. Speck pushed hard for an early decision, pointing out that the company will lose valuable tax advantages if the franchise transfer isn't accomplished by Dec. 29.

Concerns over the transfer fall into three categories:

■ **Rate hikes:** Deborah Lewis of the Seattle City Office of Cable Communications called the 17.5 percent increase "very high," but Rice said it is difficult if not impossible for a city council to stop such price leaps under the free-enterprise atmosphere of deregulation.

But, in an interview, TCI-Group W spokesman Bill Covington said some customers may actually save money, since the new TCI schedule offers several programs for free that customers formerly had to pay for.

■ **Channel number switching:** The changing of FCC-assigned channel numbers was the biggest bone of contention at yesterday's hearing. KSTW general manager Kevin Hale said his station has spent the last 23 years, not to mention millions in advertising and promotion, fixing Channel 11 in the minds of viewers. Stations such as KING and KOMO have the advantage of call letters that spell out a pronounceable name. When your letters are KSTW or KCPQ, community identification with your number is crucial, Hale said.

Calling himself an angry Irishman, KCPQ owner Robert Kelly vowed that local broadcasters will mobilize to fight what he called "the autocratic, public-be-damned behavior" reflected in the proposed changes, which he claimed will confuse the public and cripple the ability of independent stations to compete.

And, while not directly affected, managers of KING, KOMO and KIRO also voiced concern. "Who's next?" asked KIRO program director Nick Freeman.

TCI's Speck claimed that the changes are in response to a survey that included 2,000 Seattle cable customers. Those surveyed were asked what types of programs they preferred and if they would like a system that would get rid of the cable switch-box, allowing them to use their remote controls.

But those questioned were not asked about the changing of channel numbers, and only new, "cable-friendly" TV sets allow full access to cable stations via remote control. Councilwoman Jeanette Williams voiced doubt that the survey, and not economic gain, really lay behind TCI's proposal.

Speck said the company is doing what it can to diminish confusion by clustering the independent stations together at the upper end of the dial. And TCI divisional vice president Barry Marshall asked, "Why should a Channel 11 or 12 have preferential position over a Channel 22? I believe in the free enterprise system. This (channel-changing) may cause a few problems for a short time, but broadcasters are alleging that the consumers aren't bright enough to adjust."

When similar station switching was proposed in the Los Angeles area, broadcasters and cable companies agreed to leave stations where they were. Rice said he will urge that kind of compromise here, but Marshall said that kind of agreement "smacks of antitrust to me."

■ **Cable monopolies:** The takeover itself raises broader questions about the emergence of huge cable monopolies under cable deregulation, an emergence Councilwoman Williams described as "dangerous."

"We now have a situation where a monopoly comes in and tells people what they will get and how much they will pay for it," KCPQ's Kelly claimed.

Decisions made in Seattle may affect the handling of cable takeovers pending across the country.

"What TCI is doing certainly isn't illegal," said KOMO manager Ed Lackner. "I don't know what recourse there is except to persuade cable systems it is not in the public's best interest or in their own" to change the numbers of existing stations.

But Marshall of TCI said local broadcasters are only worried about their own business interests, not public welfare. "These are the same guys who fought us (cable) for years and would just as soon have seen cable go away," he said.

Other issues raised at yesterday's hearing included concerns that:

■ In hilly Seattle, many people subscribe to cable simply to get better reception, not to have access to cable extras, and that these people might not be served by the changes.

■ Low- and fixed-income people who tend to have older TV sets will be charged more but might not get the advantages offered under the new system.

■ Acceptance of this plan might open the door to further chaos in the future.

Williams worried that no private citizens spoke at yesterday's session, and she hopes customers will come forward at the decisive meeting set for the morning of Dec. 17. No time has yet been set.

But letters protesting the dropping of Channel 28, Tacoma's public-TV station, have already been received by the Post-Intelligencer.

Viacom, the Northwest's next-largest cable system, also plans changes, including a rate hike, after the first of the year. But Viacom spokeswoman Carol Summers said the company will not move independent stations from their designated dial slots.

TCI's Speck left yesterday's hearing disappointed, saying his company is being unfairly blamed as "the bad guy." But TCI has earned its tough reputation in other cities, including the Denver area, where the company is based.

In Vail, Colo., when TCI couldn't get the rate increase it sought from the city council, the company turned off the cable system entirely and, instead of programming, ran the phone numbers of the mayor and the city manager for an entire weekend.

# Group W Cable changes likely to generate grumbles

One of the things about TV that seems to appeal to viewers is familiarity — tradition, comfortable patterns of programs seen at the same time on the expected channel.

It's why people continue to watch repeats of old shows, or stick with Johnny Carson, switch to the news at 6 p.m., or reach for "60 Minutes" at 7 p.m. on Sundays. Because TV is like a member of the family, viewers get annoyed at "surprises."

That, however, seems to be something the cable industry has never fully appreciated. They no more than get their viewers comfortable with one schedule than they change everything, usually resulting in a flurry of grumbles and complaints. It's about to happen again.

**Come Jan. 5,** Group W Cable is planning a major reorganization that includes the introduction of some new channels, a restructuring of where you'll find some of the old channels — and a slight rate increase. Gone will be the "tier" system, which charged a small fee for several specialized channels like Arts & Entertainment and The Learning Channel.

At that time, everything that Group W carries, with the exception of four pay services — HBO, Showtime, Disney and Cinemax — will be available for the basic fee of $15.50 per month. (The basic fee is now $13.18, and that does not include the "tier" programs.)

One of the new channels to premiere in January is "American Movie Classics" (on Channel 6), a free, commercial-free channel that shows old movies from 4 p.m. to 4:30 a.m. weeknights and from 10 a.m. to 4:30 a.m. on weekends. It's a movie service put together by T.C.I., the cable system that purchased the local Group W system last year (but which has not yet affixed its name to the service).

**JOHN VOORHEES**
Times television columnist

Some of the movies airing in November on American Movie Classics Channel (which is sold as a pay service in some areas) are from the 1970s, but the bulk of them are from the 1930s, '40s and '50s — movies like "Orchestra Wives" with Glenn Miller, "Meet John Doe" with Gary Cooper, and a Betty Grable festival.

**Another new channel** will be the Discovery Channel (33), which emphasizes nature, science and technology, history and exploration — programming similar to "Discover," "National Geographic" and "Smithsonian." It is, however, advertiser-supported, which means there will be commercial interruptions.

On the other hand, Group W also will be introducing Cable Value Network (15), which will be one long commercial — it's a so-called "shopping channel." Also new is The Weather Channel (14) and the Black Entertainment Channel, which will share Channel 34 with The Learning Channel, just as Spanish International Network, which is on in the afternoons and evenings, will share Channel 35 with the Financial News Network, which is on in the mornings and afternoons.

The biggest gripe may well be that Group W is moving Channels 11 and 13 from their accustomed places. Come January, in attempt to group all of the independent stations together, KSTW-TV (Channel 11) will be found on Channel 23, KCPQ-TV (Channel 13) on Channel 24, KTZZ-TV (Channel 22) on Channel 25 and KTBW-TV (Channel 20) on Channel 26. Moving Channels 11 and 13 is likely to annoy not only viewers, but the managements of those stations as well.

**Disappearing from Group W's** schedule will be BCTV-TV (Channel 8) from Canada, the Home Theater Network and — sob! sob! — KTPS-TV, Channel 28, in Tacoma, the area's second public-TV station.

One of the great things about cable is that both Viacom and Group W have been carrying KTPS-TV in addition to KCTS-TV (Channel 9). This means that viewers usually have extra chances to catch "Masterpiece Theater" and a lot of other PBS programming, since Channels 9 and 28 generally carry most PBS programming at different times.

In fact, viewers often turn to Channel 28 first because it is more likely to carry the PBS schedule at the time PBS planned than is Channel 9. The Seattle station has a penchant for animal programs in prime time and shunting documentaries or anything even slightly controversial to times such as midnight or Sunday afternoon, where they will have the smallest audience possible.

Viacom subscribers aren't going to fare any better since Viacom plans to drop KTPS-TV late in December in order to add The Nickelodeon Channel. Viacom also plans a few changes after the first of the year, as well as a small rate increase, but is not yet ready to announce those changes.

TACOMA NEWS TRIBUNE - Wednesday, Nov 12th, 1986

# Group W to shuffle local channels

## In April, Tacoma subscribers may need a scorecard

Andee Beck

Cable viewers of Tacoma, I've got good news and bad news for you.

The good news is, you don't live in Seattle. Group W Cable subscribers there will find themselves in January paying more for basic cable and needing a score card to find their favorite stations. While network affiliates will stay where they are on the dial, KSTW, Channel 11, moves to cable channel 23; KCPQ (13) to cable channel 24; and KTZZ (22) to 25.

The bad news is, if you're one of Group W's 30,000 Tacoma-area viewers, chances are those changes will come your way in April.

Tele-Communications Inc. (TCI), the industry giant that swallowed Group W last June, is sending letters this week to Seattle subscribers announcing the addition of some program services, the deletion of KTPS (because it's duplicative of Seattle public station KCTS), and a realignment of the channel lineup. And while it's upping the monthly fee, charges for additional outlets are being dropped.

TCI does not plan to do the same to Tacoma's system — for now. But come April, Gary Hokenson, Washington state general manager for TCI Cablevision, says subscribers will see some changes. Hokenson maintains the plans for cutting some stations or switching the channels are vague, although we can expect KTPS to stay and KSTW (11) to stay in place.

Viacom Cablevision is also avoiding comment on specifics because management is still discussing a variety of proposals. But Seth Morrison, Viacom's marketing manager in Tacoma, says he's "99.9 percent sure we won't move the broadcast channels around." There may be some increase for services, and a decrease for others, and yes, some of the other channels will probably be moved around.

And why all these changes after the first of the year? Because recent federal decisions, effective Jan. 1, give cablers more freedom than they've ever known. They can change the rates without the city's approval, they can change the channels without subscribers' approval. Shoot, if they've got millions to burn, mavericks can come into town and starting competing with each other for your subscribership.

You don't want to pay more for basic cable? And you're not crazy about the stations being moved hither and yon?

Tough, say the big boys.

TCI's Hokenson maintains, "It's just a matter of re-educating people" about where those 36 program services are. And even if we complain, they're not changing back.

The local independent stations are furious. KSTW, KCPQ and KTZZ worry with good reason that viewers won't know where to find them up in the stratosphere of the TV dial.

What does TCI have to say to those concerns? As Barry Marshall, a top TCI official, rumbled to a cable trade journal last week: "Goddamn it, it's my cable system and I paid millions to build the plant. I get mad when they tell me how I can run my store."

Some day real soon, before VCRs strangle cable completely, companies such as TCI may learn the hard way to treat the customer with a little respect.

[From the Daily Oklahoman, November 3, 1986]

# Cable Channel Switching Causing Stir

**By Chuck Davis**

**Cox Cable of Oklahoma City's decision to move local television stations off-channel in January may be causing more problems than it is solving.**

**Cox denies that its move is anything but an attempt to provide better service to its subscribers.**

**The company has announced that Jan. 5, it will move local television stations and other cable channels to new locations on the dial.**

**According to a press release issued by the company last week, "The channel realignment will mean improved reception for Cox Cable customers.... The move will eliminate direct pickup (DPU) effects which often result when local VHF stations are carried on their broadcast channel numbers.**

"When direct pickup occurs," the release says, "it is most often seen by cable television customers as a double image (ghost) frequently accompanied by a vertical bar on the viewer's TV screen ..."

As it stands now, KTVY-TV Channel 4 will be moving to Cox channel 7, KOCO-TV Channel 5 will be moving to Cox channel 8 and KWTV-TV Channel 9 will be moving to Cox channel 10.

Local independent stations located on channels 13, 25, 34 and 43 also will be moved, although their locations on the dial have not been decided.

One source told *The Oklahoman* that Cox at first had planned to relocate KAUT-TV Channel 43, on Cox channel 34. KGMC-TV Channel 34 is a direct competitor with KAUT and KOKH-TV Channel 25.

The moves, and similar moves by other cable companies across the nation, have incensed some local and national independent station managers and top executives.

One general manager of an independent TV station in Oklahoma City, aware of Cox's plan to move him "off-channel," said the situation runs "far deeper than (fixing) poor signals."

He requested anonymity but referred *The Oklahoman* to Preston Padden, president of the Association of Independent Television Stations, in Washington, D.C.

"What Cox Cable is saying in its (press) release is a patent falsehood," Padden said.

"The cable TV industry has succeeded in becoming an unregulated monopoly. Federal statutes state that their most likely competitor, the phone company, cannot carry TV cable signals," Padden said.

"Federal laws also say that the cable operators can take (or leave) any signal they want. The FCC rule — not a law — used to be that cable operators had to carry the local stations, including the independents.

"The FCC ruling (often referred to as the "must-carry" ruling) was knocked out in court, however."

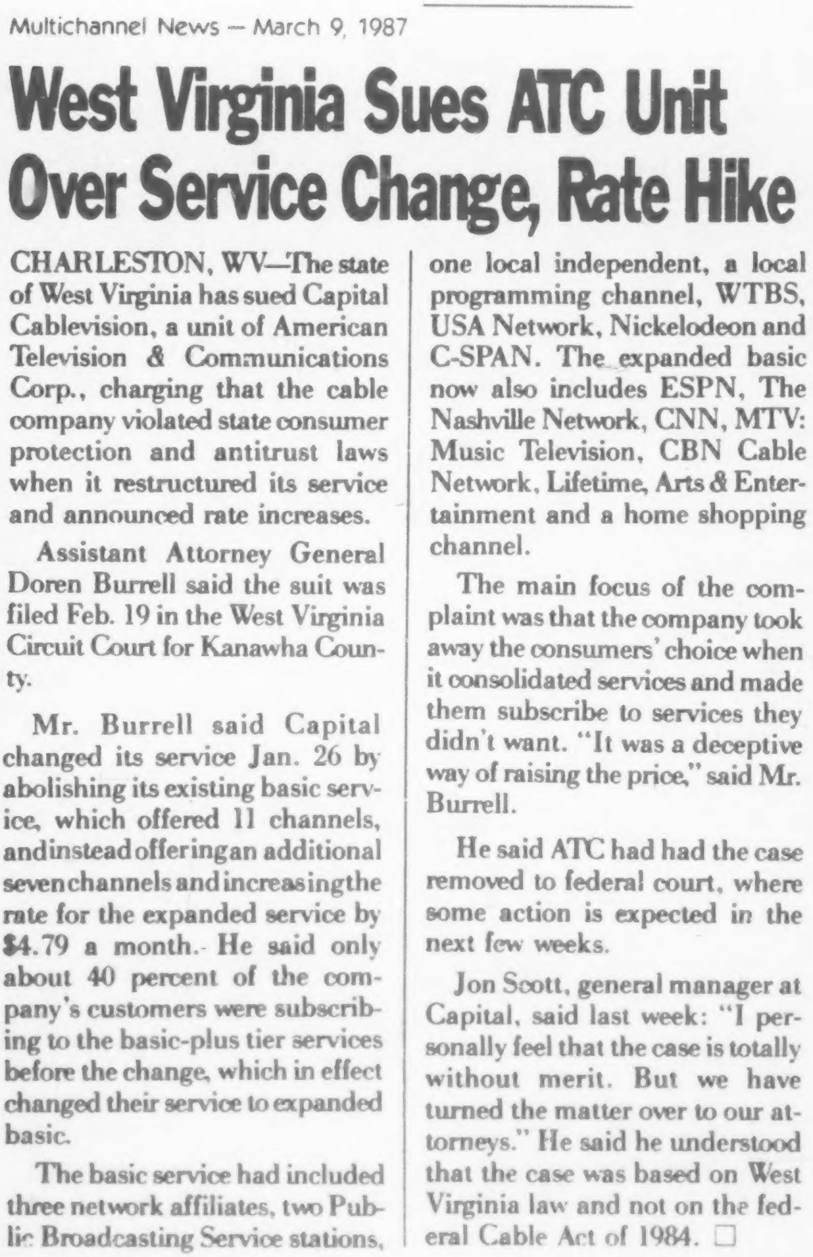
Now, Padden said, "The cable operators can pick and choose anybody's signal they want — and not pay the station a nickel.

"This whole operation, at Cox Cable and elsewhere across the United States, is not being done to eliminate the ghosts. It's, one, to have an excuse to gouge more money out of the subscribers, and, two, to gin up the viewership of cable ad-supported services, like ESPN, MTV and the like."

Jill Trione, director of communications and programming for Cox Cable, said, "We didn't do this for any reason other than to eliminate the ghosting problems and the DPU problems, and to provide better service for our subscribers."

Attachment No. 7

## West Virginia "Tie-in" Lawsuit



Multichannel News — March 9, 1987

# West Virginia Sues ATC Unit Over Service Change, Rate Hike

CHARLESTON, WV—The state of West Virginia has sued Capital Cablevision, a unit of American Television & Communications Corp., charging that the cable company violated state consumer protection and antitrust laws when it restructured its service and announced rate increases.

Assistant Attorney General Doren Burrell said the suit was filed Feb. 19 in the West Virginia Circuit Court for Kanawha County.

Mr. Burrell said Capital changed its service Jan. 26 by abolishing its existing basic service, which offered 11 channels, and instead offering an additional seven channels and increasing the rate for the expanded service by $4.79 a month. He said only about 40 percent of the company's customers were subscribing to the basic-plus tier services before the change, which in effect changed their service to expanded basic.

The basic service had included three network affiliates, two Public Broadcasting Service stations, one local independent, a local programming channel, WTBS, USA Network, Nickelodeon and C-SPAN. The expanded basic now also includes ESPN, The Nashville Network, CNN, MTV: Music Television, CBN Cable Network, Lifetime, Arts & Entertainment and a home shopping channel.

The main focus of the complaint was that the company took away the consumers' choice when it consolidated services and made them subscribe to services they didn't want. "It was a deceptive way of raising the price," said Mr. Burrell.

He said ATC had had the case removed to federal court, where some action is expected in the next few weeks.

Jon Scott, general manager at Capital, said last week: "I personally feel that the case is totally without merit. But we have turned the matter over to our attorneys." He said he understood that the case was based on West Virginia law and not on the federal Cable Act of 1984. ☐

IN THE CIRCUIT COURT OF KANAWHA COUNTY, WEST VIRGINIA

STATE OF WEST VIRGINIA ex rel.
CHARLES G. BROWN, Attorney
General,

Plaintiff,

v. Civil Action No. 87-C-659

AMERICAN TELEVISION & COMMUNICATIONS, INCORPORATED, doing
business as Capitol Cablevision,

Defendant.

Kanawha Circuit Court
Clerk's Office

FEB 19 1987

## COMPLAINT

### PARTIES

1. Plaintiff State of West Virginia is a sovereign state, in whose name this action is brought by, and upon the relation of, Charles G. Brown in his official capacity as the Attorney General of the State of West Virginia.

2. Relator Charles G. Brown is the duly elected, qualified, and acting Attorney General of the State of West Virginia and is entitled to bring this action in the name of the State by virtue of the provisions of W. Va. Code §§ 46A-7-108, 46A-7-110, and 47-18-8.

3. Defendant American Television & Communications, Incorporated, is a corporation organized under the laws of the State of Delaware, authorized to do business in the

State of West Virginia, and which does business in the State of West Virginia under the name of Capitol Cablevision.

## JURISDICTION AND VENUE

4. This complaint is filed and the jurisdiction of this Court invoked by plaintiff pursuant to the provisions of W. Va. Code §§ 46A-7-108, 46A-7-110, and 47-18-8.

5. Venue in this Court is proper pursuant to the provisions of W. Va. Code §§ 46A-7-114 and 47-18-15.

## BACKGROUND

6. All the allegations in this complaint concerning the defendant are intended to refer to the defendant's operations conducted under the name Capitol Cablevision, and to activities of the defendant, its subsidiaries, agents, employees, and executives necessary to carry out such operations.

7. The defendant provides services, referred to hereinafter as "cable TV services," consisting of the reception of video signals and the re-transmission of those signals through high-quality, closed-path transmission lines to consumers, termed "subscribers," in return for a monthly service fee.

8. The defendant provides cable TV services to residents of the cities of Dunbar, West Virginia, South Charleston, West Virginia; and Charleston, West Virginia, under franchises granted by the respective municipal governments of those cities.

9. Defendant is the only business entity currently holding a franchise to provide cable TV services in the city of Dunbar, West Virginia.

10. Defendant is the only business entity currently holding a franchise to provide cable TV services in the city of South Charleston, West Virginia.

11. Defendant is the only business entity currently holding a franchise to provide cable TV services in the city of Charleston, West Virginia.

12. Prior to January 26, 1987, and beginning at a time unknown to the plaintiff, the defendant offered three categories or tiers of cable TV service described as follows:

a. "Basic service" consisting of the reception and re-transmission of signals primarily from local television stations, broadcasting at very high frequency (VHF) and ultrahigh frequency (UHF) wavelengths, and from some additional, nonlocal stations or networks;

b. "Tier service" consisting of the reception and re-transmission of signals, originating outside the State of West Virginia, from specialized networks or stations which derive a portion of their revenue from commercial advertising and whose signals are broadcast at microwave frequencies through a network of relay stations and communications satellites; and

c. "Premium services" consisting of the reception and re-transmission of signals, originating outside the State of West Virginia, from premium networks, i.e., Home Box Office, Cinemax, and the Disney Channel, which do not carry commercial advertising and which are broadcast at microwave frequencies through a network of relay stations and communications satellites.

13. The majority of signals or channels included in the Basic service may also be received by consumers with conventional television antennas.

14. Consumers can not receive any of the signals or channels included in the Tier service with conventional television antennas, although some of those signals may be received with parabolic reflector, microwave antennas, commonly known as satellite dish antennas.

15. None of the signals or channels offered by the defendant as Premium services may be received with conventional television antennas; nor can such signals be received for viewing with parabolic reflector, microwave antennas unless the viewer uses special decoding equipment under license from the originators of those signals.

16. Use of unlicensed decoding equipment to view premium, "pay cable" signals is a violation of federal law.

17. Prior to January 26, 1987, subscribers to the Basic service could view all signals provided in that service on a conventional television set.

18. Prior to January 26, 1987, subscribers to the Tier service could only view signals provided in that service with the aid of a cable "converter box."

19. Prior to January 26, 1987, the defendant charged a deposit fee to all subscribers using converter boxes.

20. The defendant currently charges, and has charged throughout the preceding year, a fee of $7.16 per month for subscription to its Basic service and an additional fee of $4.95 for subscription to its Tier service.

21. Prior to January 26, 1987, the defendant provided cable TV services to approximately 30,000 subscribers in its franchise areas, reaching more than seventy-six percent (76%) of the households in the combined areas.

22. Of the defendant's 30,000 subscribers, more than fifty percent (50%), or 15,000 subscribers, chose not to subscribe to the Tier service.

23. On January 26, 1987, the defendant rearranged the assignment of individual signals to various television channels in order to promote and carry out a change in its services, combining the previous Basic service with Tier service to create one category of service termed "Expanded Basic service," eliminating the consumers' option of subscribing to Basic service only.

24. Beginning January 26, 1987, and continuing thereafter, subscribers to the previous Basic service have been unable to receive all of the signals provided in that service on conventional television sets.

25. On various dates, including January 26, 1987, and thereafter, the defendant has advertised, through newspapers of general circulation and through direct mailings to consumers, that the combined service is a "better" version of the previous Basic service and that the fee for the combined service would be $11.95 per month.

26. The defendant has advertised that it will bill subscribers to its previous Basic service at the new, combined rate beginning March 1, 1987.

27. The defendant is taking and has taken steps, such as the distribution of converter boxes and the rearrangement of its signals corresponding to various television channels, to effect the change to the "Expanded Basic service" for all of its subscribers regardless of the subscribers' preferences for the various categories of services.

## COUNT I

28. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and re-alleges the facts set forth in paragraphs 1 through 27 above.

29. By its actions, the defendant has unfairly and deceptively consolidated its services to limit and reduce consumer product options and by incorporating its Basic service and Tier service into one combined service, the defendant has unfairly and deceptively forced a substantial number of consumers to purchase a product which they do not wish to buy.

30. By incorporating its Basic and Tier service into one combined service, the defendant has unfairly and deceptively raised the price of its Basic service to approximately 15,000 consumers.

31. The defendant's actions, set forth in paragraphs 6 through 30 above, are unfair and deceptive acts and practices detrimental and injurious to the public interest and in violation of W. Va. Code § 46A-6-104.

## COUNT II

32. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and re-alleges the facts set forth in paragraphs 1 through 27 above.

33. On various dates on and about January 26, 1987, the defendant has advertised, published, and distributed, and caused to be advertised, printed, displayed, published, distributed, and broadcast, statements and representations with regard to the sale of cable TV services, stating that its new "Expanded Basic service" will cost "only $11.95" per month, that this is an "adjusted" rate for the Basic service, that the change to "Expanded Basic service" expands viewer choices while maintaining the same cost per channel and that this charge will mean a lower bill for those who had subscribed to both the Basic and Tier services.

34. The statements referred to in paragraph 33 above are misleading and deceptive in that they fail to state that the $11.95 monthly charge represents a price increase for subscribers to the previous Basic service, that the amount of the increase is $4.79, which is 66.7% more per month than the previous rate and that the corresponding decrease for subscribers to the Basic and Tier services is only a nominal sixteen cents ($0.16) per month.

35. The actions of the defendant described in paragraphs 6 through 27 and paragraphs 33 and 34 above are unfair and deceptive acts or practices as defined in subsections (12), (13), and (14) of W. Va. Code § 46A-6-102(f), detrimental and injurious to the public interest and in violation of Code 46A-6-104.

## COUNT III

36. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and re-alleges the facts set forth in paragraphs 1 through 27 above.

37. On various dates on and about January 26, 1987, the defendant has advertised, published, and distributed, and caused to be advertised, printed, displayed, published, distributed, and broadcast, statements with regard to the sale of its cable TV services, stating that converter boxes would now be provided to subscribers "free."

38. The statements referred to in paragraph 37 above are false, misleading, and deceptive because they fail to state that subscribers who wish to use a remote control with their television sets must pay four dollars ($4.00) per month for a special converter box and because the defendant has expressed an intention to increase its rates in the future to recoup its costs in providing the thousands of converter boxes necessary to effect the change to the "Expanded Basic service."

39. The actions of the defendant described in paragraphs 6 through 27 and paragraphs 37 and 38, above, are unfair and deceptive acts or practices as defined in subsections (5), (11), (12), (13), and (14) of W. Va. Code § 46A-6-102(f), detrimental and injurious to the public interest and in violation of Code 46A-6-104.

## COUNT IV

40. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and re-alleges the facts set forth in paragraphs 1 through 27 above.

41. The defendant is the sole business entity providing video reception services of premium channel signals within the cities of Charleston, South Charleston, and Dunbar, West Virginia.

42. Premium channel signals are encoded, "scrambled," so that they may only be received by consumers who subscribe to defendant's Premium services.

43. Beginning at a date unknown to the plaintiff and continuing to the present, the defendant has provided its Premium services only upon the condition that the consumer also subscribe to the Basic service.

44. By virtue of the defendant's exclusive position in the market for premium channel reception, the defendant has substantial market power to force consumers of the Premium service to subscribe to the Basic service as well.

45. Defendant's Basic service and Premium service are distinct products for which the defendant charges separate fees and for which there are distinct differences in consumer demand.

46. Tying the purchase of Premium services to the purchase of the Basic service distorts competition in the market for reception of local broadcast signals and restrains trade in consumer alternatives to Basic service such as conventional television antennas and related equipment.

47. Tying the purchase of Premium services to the purchase of Basic service adversely affects more than 5,000 consumers and involves more than $100,000.00 per month in subscription fees.

48. By conditioning the sale of its Premium services upon the additional purchase of the Basic service, the defendant has created and maintained unlawful "tie-in" contracts in restraint of trade and competition in violation of W. Va. Code § 47-18-3(a).

## COUNT V

49. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and re-alleges the facts set forth in paragraphs 1 through 27 above.

50. Prior to January 26, 1987, defendant's Tier service consisted of the following special-programming format, microwave networks: Cable News Network, The Nashville Network, Eastern Sports Network (ESPN), Home Shopping Network, Arts and Entertainment Network, Music Television, Christian Broadcasting Network, and Lifetime Health Network.

51. With the exception of the Cable News Network, which uses an electronically scrambled signal, the signals from the networks included in defendant's Tier service may also be received through the use of satellite dish antennas.

52. Under ordinances of the City of Charleston, the City of South Charleston, and the City of Dunbar, West Virginia, businesses and residents in those communities are severely restricted as to where they may have satellite dish antennas.

53. Signals from special-programming format, microwave networks are products distinct from signals from locally broadcast, conventional television frequency stations providing general programming.

54. Defendant's Tier service consists entirely of the reception and re-transmission of signals from special-programming format, microwave networks.

55. Defendant's Basic service consists primarily of the reception and re-transmission of signals from local, conventional television frequency stations providing general programming.

56. Defendant's Tier service and Basic service are distinct products for which the defendant has charged separate fees and for which there are distinct differences in consumer demand.

57. Beginning at a date unknown to the plaintiff and continuing to the present, the defendant has provided its Tier service only upon the condition that the consumer also subscribe to the Basic service.

58. By virtue of the defendant's position as the sole commercial reception service for special-programming format, microwave network signals the defendant has substantial market power in the cities of Dunbar, South Charleston, and Charleston, West Virginia, to force consumers of the Tier service to subscribe to the Basic service as well.

59. Tying the purchase of Tier service to the purchase of Basic service distorts competition in the market for reception of local broadcast signals and restrains trade in consumer alternatives to Basic service such as conventional television antennas and related equipment.

60. Tying the purchase of satellite Tier service to the purchase of Basic service adversely affects more than 12,000 consumers and involves more than $14,340.00 per month in subscription fees.

61. By conditioning the sale of its Tier service upon the additional purchase of Basic service, the defendant has created and maintained unlawful "tie-in" contracts in restraint of trade and competition in violation of Code 47-18-3(a).

## COUNT VI

62. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and re-alleges the facts set forth in paragraphs 1 through 27 above.

63. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and realleges the facts set forth in paragraphs 41 through 47 above.

64. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and realleges the facts set forth in paragraphs 50 through 60 above.

65. By conditioning the sale of its Premium services and the sale of its Tier service upon the additional purchase of the Basic service, the defendant has engaged in unfair methods of competition in the market for the reception of local broadcast television signals in violation of W. Va. Code § 46A-6-104.

## COUNT VII

66. Plaintiff State of West Virginia, by its Attorney General, Charles G. Brown, repeats and re-alleges the facts set forth in paragraphs 1 through 27 above.

67. The defendant provides discrete services, referred to herein as cable TV services, as its primary business.

68. The defendant is the only provider of commercial cable TV services in the cities of Charleston, South Charleston, and Dunbar, West Virginia.

69. The defendant has announced that it will raise the price of its Basic service by 66.7% and that, after expenses resulting from a change of services, the defendant expects to maintain a reasonable margin of profit.

70. The defendant has substantial power over the price of its services because consumers do not consider other reception products or services to be acceptable substitutes.

71. The defendant maintains a monopoly over the supply of cable TV services within the cities of Charleston, South Charleston, and Dunbar, West Virginia.

72. The imminent restructuring of prices for defendant's Premium services and the imminent increase in the price of its Basic service constitutes use of a monopoly for the purpose of controlling prices in violation of W. Va. Code § 47-18-4.

## PRAYER

WHEREFORE, plaintiff State of West Virginia prays that this Honorable Court will grant the following relief:

1. A preliminary order enjoining the defendant from violating the provisions of W. Va. Code §§ 46A-6-104, 47-18-3(a), and 47-18-4 as described in Counts I through III and Count VI of this complaint, including completing the combination of Basic service and Satellite Tier service into "Expanded Basic service," charging subscribers to the Basic service for the combined service, and all acts, including

advertising, in furtherance thereof during the pendency of this action;

2. Permanent injunctive relief enjoining the defendant from violating the provisions of W. Va. Code §§ 46A-6-104, 47-18-3(a) and 47-18-4 by unlawfully combining its services or conditioning the purchase of one service upon the additional purchase of another service and thereby preventing consumers from making independent purchase choices and forcing consumers to purchase services which they do not desire;

3. Full restitution to each consumer adversely affected by defendant's violations of W. Va. Code § 46A-6-104 described in Counts I-III of this complaint;

4. Appointment of a receiver for the sequestration of liquid assets and to preserve restitution for consumers found to have been damaged by defendant's actions;

5. Civil penalties in the amount of $5,000.00 for each violation of W. Va. Code § 46A-6-104 as set forth in Counts I, II, III, and VI of this complaint;

6. Civil penalties in the amount of $100,000.00 for all violations of W. Va. Code §§ 47-18-3 and 47-18-4 as set forth in Counts IV, V, and VII of this complaint;

7. An award of plaintiff's costs in this action, including, but not limited to, filing fees, witness fees and expenses, and costs related to the production of non-testimonial evidence;

8. An award of reasonable attorney fees and investigative costs for time involved in the investigation and pursuit of this action; and

9. All other orders and judgments the Court shall deem just and proper to effectuate the purposes of the West Virginia Antitrust Act, W. Va. Code § 47-18-1 et seq., the West Virginia Consumer Credit and Protection Act, W. Va. Code § 46A-1-1 et seq., and other general laws of the State of West Virginia.

STATE OF WEST VIRGINIA ex rel.
CHARLES G. BROWN, Attorney
General,
Plaintiff,

By Counsel

Charles G Brown
CHARLES G. BROWN
ATTORNEY GENERAL

MARK KINDT
DEPUTY ATTORNEY GENERAL
State Capitol, Room 26-E
Charleston, West Virginia 25305

Counsel for Plaintiff

STATE OF WEST VIRGINIA,

COUNTY OF KANAWHA, to-wit:

## VERIFICATION AFFIDAVIT

The undersigned, Charles G. Brown, after being duly sworn, deposes and says:

I hereby verify that the allegations set forth in the foregoing complaint are true, except insofar as they are therein stated to be upon information and belief, and insofar as they are stated to be upon information and belief, I believe them to be true.

Charles G Brown
CHARLES G. BROWN

Taken, subscribed and sworn to before me this 19th day of February, 1987.

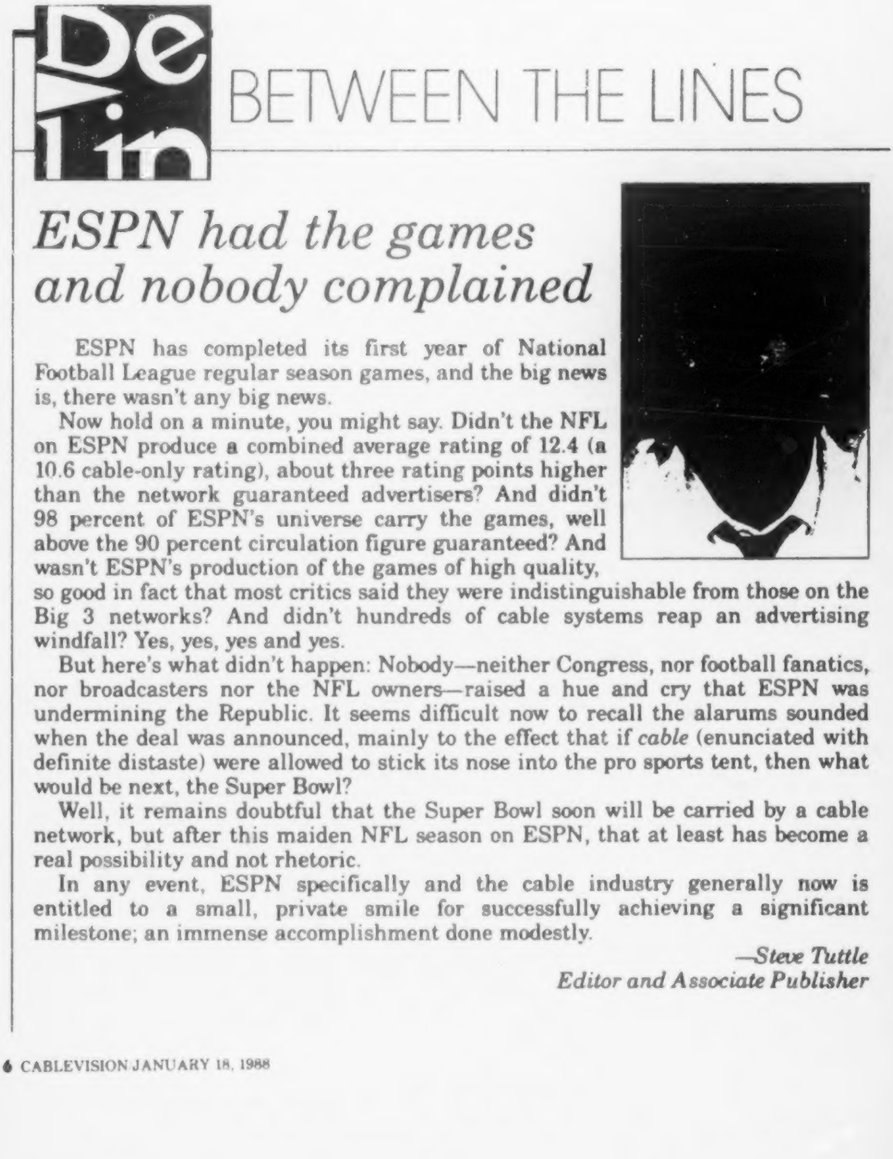
My commission expires July 19, 1994.

JA[illegible] W. MARTIN
MY COMMISSION EXPIRES JULY 19, 1994

Janette W. Martin
Notary Public

Attachment No. 8

"Siphoning" of NFL Games
From Free TV to Pay Cable



## BETWEEN THE LINES

## *ESPN had the games and nobody complained*

ESPN has completed its first year of National Football League regular season games, and the big news is, there wasn't any big news.

Now hold on a minute, you might say. Didn't the NFL on ESPN produce a combined average rating of 12.4 (a 10.6 cable-only rating), about three rating points higher than the network guaranteed advertisers? And didn't 98 percent of ESPN's universe carry the games, well above the 90 percent circulation figure guaranteed? And wasn't ESPN's production of the games of high quality, so good in fact that most critics said they were indistinguishable from those on the Big 3 networks? And didn't hundreds of cable systems reap an advertising windfall? Yes, yes, yes and yes.

But here's what didn't happen: Nobody—neither Congress, nor football fanatics, nor broadcasters nor the NFL owners—raised a hue and cry that ESPN was undermining the Republic. It seems difficult now to recall the alarums sounded when the deal was announced, mainly to the effect that if *cable* (enunciated with definite distaste) were allowed to stick its nose into the pro sports tent, then what would be next, the Super Bowl?

Well, it remains doubtful that the Super Bowl soon will be carried by a cable network, but after this maiden NFL season on ESPN, that at least has become a real possibility and not rhetoric.

In any event, ESPN specifically and the cable industry generally now is entitled to a small, private smile for successfully achieving a significant milestone; an immense accomplishment done modestly.

*—Steve Tuttle*
*Editor and Associate Publisher*

Attachment No. 9

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Turner Network Television Plans
to "Siphon Major Events
From Free TV to Pay Cable

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RADIO TELEVISION CABLE SATELLITE
Broadcasting Oct 12
Vol 113 No 15

# Turner's TNT adds spark to Atlantic Cable Show

**New basic cable network, planned for March launch, still needs board approval; on the wish list: major sports events including the Olympics, Academy Awards, Grammys, pageants**

Ted Turner, in a keynote address opening the Atlantic Cable Show, revealed details about his planned basic cable network, Turner Network Television, which he said would be a cable-exclusive program service built around major television events. The service, which needs the approval of the Turner board, which is scheduled to take up the matter at a meeting on Friday, Oct. 16, would be supported by both advertisers and cable operators.

Turner's superstation, WTBS(TV) Atlanta, "has gone about as far as it can go," Turner said. "I need to get subscriber fees so we can go to the next level." The fees he envisions would begin at 10 cents per month per subscriber in March 1988 and would increase to 20 cents in March 1989. He also said the network would carry 10 minutes of advertising an hour, with three to four minutes turned back to the cable operator.

The events Turner wants to go after include Major League Baseball, the National Basketball Association, NCAA basketball, all the college football bowl games and associated parades, the Olympics, the Kentucky Derby, the Daytona 500, the Indianapolis 500, the PGA, U.S. Open golf, the Masters, the British Open, Wimbledon, U.S. Open tennis, Miss USA, Miss Teen USA, Miss Universe, the People's Choice Awards, the American Music Awards, the Kennedy Center Honors, the Academy Awards, the Tony Awards and the Grammys. Turner's Goodwill Games would also appear on the new network.

Turner made it a point to claim that making the new service cable-exclusive was his idea. And he said his legal counsel has advised him that because TNT would be a startup service, it would net run afoul of antitrust laws. ★ ★ ★

Atlantic City Convention Center

Media
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# Turner sets TNT start in October

By JANET STILSON
Staff reporter

NEW YORK—Turner Broadcasting System hopes to launch Turner Network Television on Oct. 3 with a 10 million to 15 million subscriber base.

Gerald Hogan, president of TBS's entertainment network unit, is trying to nail down subscriber commitments in a series of teleconferences with the multiple cable system operator executives who attended TBS's meeting on TNT last week.

Mr. Hogan and Ted Turner, TBS's chairman and chief executive, are also talking to board members in an effort to get their approval of the proposal, including the Oct. 3 kickoff.

Representatives of about 10 of the country's largest MSOs attended the Turner meeting last week. At least one, Tele-Communications Inc. President John Malone, has given the network his full support.

Others, such as Robert Miron, president of Newhouse Broadcasting, expressed some reservations.

"It was an interesting presentation," Mr. Miron said. "Ted had some innovative program ideas."

He said some aspects of the plan, plus channel capacity considerations, will lead him to review the proposal "very carefully."

Turner's plans for a 10 million to 15 million subscriber base would be "by far the largest subscriber launch of a (cable) network," Mr. Hogan says. It would immediately make TNT eligible for A.C. Nielsen Co. ratings.

That milestone, which some cable networks have taken years to reach, is vital in attracting significant advertiser interest.

TBS sources close to the plan say systems will not be charged a per-subscriber rate during the first year, but would pay 15 cents per subscriber in 1989, 20 cents in 1990 and 25 cents in 1991.

Concerning the debut date, Mr. Hogan says, "There are probably 20 different reasons why we chose Oct. 3, but most importantly, the Olympics will be over."

A three-step programing strategy has been planned, he said, which will ultimately see the inclusion of high-profile programing "that drives new subscribers and enhances current customer satisfaction."

That has been the goal of Mr. Turner, who told the Atlantic Cable Show in October that TNT would attempt to grab rights to such TV heavyweights as the Grammy Awards, the Olympic Games, "all of baseball" and "anything else we can think of."

Says Mr. Hogan: "Initially we'll rely on our library of acquired product. But at this first stage we'll also be engaged in the development and hopefully the production of new programing."

That period, expected to last 18 months to 30 months, will be followed with a schedule integrating new, original programing.

"But whether it will be breakthrough programing or not, I don't know," Mr. Hogan says.

The final step, about five years away, will see a prime-time schedule dominated with original fare—"250 nights a year would be original, including live sports," Mr. Hogan says.

In the battle for channel space on cable systems, TNT is expected to try to replace superstations in some markets.#

Senator METZENBAUM. Thank you very much, Mr. Maltz.

Our next witness is Wendell Triplett. I will hold my questions until I have heard from this entire panel because we are running out of time. Mr. Wendell Triplett, Chillicothe, OH.

## STATEMENT OF WENDELL TRIPLETT

Mr. TRIPLETT. Thanks for the chance to testify, Senator. It is greatly appreciated.

Senator METZENBAUM. Happy to have you with us, sir.

Mr. TRIPLETT. I am here on my own behalf as a little guy trying to make a new UHF station in Chillicothe/Columbus go. And also to plead for all new stations across the country that are either trying to exist in their very early phases or trying to build new construction permits who have recently been given to them by the FCC.

We were a home shopper when we went on the air August 31. However, since January 4, we are a full, standard, independent television station. We had to sell a radio station in order to get our programming, and that did not occur until December.

My wife and I have undergone a living hell since the strikedown of must-carry on December 11, 1987. We are on three of the four cable systems in Columbus, having been taken off by Coaxial Communications Cable on approximately January 20. We are being carried by All American ATC out of Denver, Warner and Telemedia. We are very appreciative to be carried by these three systems and would rather not comment on them due to the extreme sensitivity of the problems, sir.

I will comment on Coaxial, since they have no intention of putting us back on, although we have offered consideration in the way of time for them to sell, assumption of any copyright liability. They have additional promotional time for their programming, if they would like it. They, the president and majority owner will not even meet with us to work out our differences. They only want to exchange letters with much doubletalk and confusion to obscure any real truth on the issues between us.

I would now like to comment on the damage being done to new stations and new construction permits all across the country.

Senator METZENBAUM. Who owns Coaxial, Mr. Triplett?

Mr. TRIPLETT. The major owner is—it is a fairly closely held corporation. The major owner is a gentleman who lives in Jay, NY, Mr. Silverstein.

Senator METZENBAUM. Where?

Mr. TRIPLETT. Jay, NY. That is upstate eastern New York.

Senator METZENBAUM. Is that the major cable company in New York?

Mr. TRIPLETT. It is one of the big ones. Warner is the largest, having 77,000 current subscribers. They have approximately 62,500. They are the second largest.

Senator METZENBAUM. Thank you.

Mr. TRIPLETT. The Cable Act, as has been said here many times, they must be revisited. The Government gave away the store.

New stations cannot get any financing today, Senator. None whatsoever. You cannot get any existing working capital, nor can people build new stations that they have been construction permits from the FCC because of this must-carry problem.

Many stations that are on are terrorized by the possibility of being taken off. I have talked to them all the way from Riverside to Lowell, MA, to Florida. New stations are held in bondage by cable today. Cable's goal is to sell $5 billion in advertising by early 1990's. It is pretty obvious why they do not want us new boys on the street.

Stations on cable are locked out of the home. As the NBC study showed, there is only 1 percent that have an A/B switch and only 10 percent ever look at over-the-air signals.

Not being on cable completely undermines an independent station's morale. If a station had a 2,000-foot tower in the middle of a market and it is not on cable, they will not get a decent market share to make it. If we are on cable, we will make it fine, Senator. If we are not kept on cable, we are simply going to die.

Managers and owners of new stations are fighting for their survival which undermines their ability to manage their operations. This hearing gives us hope, but it is only real if true action is taken quickly. The time profile is a great problem for new stations. If help is not received, some tremendous damage will be inflicted on these fledgling new businesses.

I have approximated that 100 stations are affected, and I will complete my studies—being an old operational analyst from RCA. And I think that there are $70 million in jobs a year are going to be lost. I think there is $500 million in revenue if this problem is not fixed.

Free local television will be dramatically affected along with diversity of views. For example, Coelho mentioned 182 PBS stations were thrown off. A couple more points, sir.

Senator METZENBAUM. Thank you very much, Mr. Triplett.

Our last witness today is Mr. John Siegel, president of KBHK-TV, San Francisco.

## STATEMENT OF JOHN SIEGEL

Mr. SIEGEL. Thank you, Mr. Chairman, for the opportunity to testify here today.

Over the past few years the cable industry has radically changed from being a benign retransmitter of local stations to becoming a powerful producer of programming that competes with the local stations.

For example, Mr. Chairman, you have listed the financial interest in cable programming channels that TCI owns or controls. Cable companies compete with local broadcasters for viewers while they control the access to the viewing choices in the home.

Virtually, 100 percent of the cable systems in this country are local monopolies. And when you combine the lack of competition and the power to control the viewing choices with a financial interest in the success of competing programming, you are left with a distorted marketplace that is far from consumer-preference driven.

Even when must-carry rules were in effect, cable companies abused their gatekeeper power contrary to overwhelming evidence of consumer preference for the local stations' programming. Only in an abusive monopoly climate can an entity reap higher and higher profits by not responding to consumer preference.

Absent must-carry, the congressionally guaranteed compulsory license along with the lack of strict syndicated exclusivity provisions operate to enable cable companies to further distort the competitive process.

Under the compulsory license, for virtually no cost cable companies regularly import distant television signals. Often these stations air the same shows as the local station and often in the same time period.

It can hardly be suggested that viewers desire the same programming to appear on two, three, or four channels. But because cable companies compete for viewers and advertising revenue against local stations, it is to the cable's benefit to dilute the value of its competitor's programming.

One cable system in San Francisco, United Cable, a TCI subsidiary, takes this unfair practice one step further. They refuse to list KBHK in their cable guides with most of the other Bay Area stations, but they do list a distant UHF station from Sacramento which airs much of the same programming KBHK airs.

Let me tell you a little about what my station has gone through in the last couple of years. Years and years ago my station was San Francisco Cable Company's best friend. We worked with them to help promote cable subscribership. In exchange, we successfully unified our channel location to channel 12 on virtually all of the Bay Area cable systems.

But as our historically good relationship based on interdependence became one of competition, things began to change. In late 1986, we began to hear rumors of a marketwide cable channel repositioning plan to unify all cable and broadcasting channels in the Bay Area. The plan had us slated to be moved to what we call "Siberia." This despite consumer preference for our programming over any other cable programming, and despite the fact that we were already unified.

We first went to the various Bay Area municipalities to persuade them that they could protect local consumer preference. But the cable companies stormed in wrapping themselves in the Cable Act, the first amendment, and threatened suit. Obviously, the local municipalities were intimidated.

Thereafter, we brought suit in State court alleging anticompetitive behavior and unfair competition. We now have resolved our differences with the named defendant Viacom in that suit, but our cable position is fragile at best. In fact, by testifying here today I fear retribution by cable companies in the Bay Area, especially TCI. TCI and KBHK are at great odds, ever since they moved us in 1986 and inserted their owned and ad-supported channel in our place contrary to consumer preference.

In conclusion, cable is an unfair competitor. They reap higher and higher profits contrary to clear consumer preference. Congress should launch an investigation of its own into cable's concentration of power. It should look into amending the Cable Act to protect consumers and local broadcasters from cable's anticompetitive behavior. It should tie the compulsory copyright license to must-carry and syndicated exclusivity. And it should prevent channel shifting without a clear-cut showing of consumer preference.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Siegel follows:]

# TESTIMONY OF JOHN SIEGEL,
PRESIDENT OF KBHK, SAN FRANCISCO,
BEFORE THE SENATE COMMITTEE ON THE JUDICIARY,
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS
MARCH 17, 1988

Thank you, Mr. Chairman, for inviting me to appear before this distinguished Subcommittee. My name is John Siegel. I am President of San Francisco independent T.V. station KBHK. I also serve on the Board of Directors of KBHK's parent company, United Television, Inc., a publicly traded company. Chris-Craft Industries, another public company, controls 51 percent of United Television's stock and I am a Vice President of Chris-Craft.

KBHK is the number 2 independent T.V. station in the competitive San Francisco television market. In terms of audience appeal (i.e., consumer acceptance) KBHK is the fastest growing television station in the market.

KBHK is a member of the Chris-Craft/United Television group of television stations. This group is the eighth largest broadcasting group in the U.S. and the largest group west of the Mississippi.

## I. OVERVIEW

The cable industry has changed dramatically in recent years. It can no longer be dismissed as a friendly group of "mom and pop" entrepreneurs trying to improve television reception in a few isolated communities for the benefit of consumers. Today, more than half the households in America receive their television programming through a cable. The cable industry expects to be a $15 billion industry by 1991. And for this year, cable's largest company, TCI, is projecting a $1 billion cash flow.

As the C-SPAN cameras make us all aware, cable television programming is no longer limited to broadcast transmissions, but instead a multitude of competing program services. The alphabet soup of TDC, CNN, TNT, MTV, and CVN pervades the industry. Indeed, the expansion in the scope of the cable industry is matched only by the consolidation in its ownership. A few media behemoths now dominate the industry. This week's Multichannel News headline uses "Godfather" to describe TCI.

The sad truth is that the modern cable industry represents the emergence of the largest unregulated monopoly in this country. Most cable operators have a de facto monopoly within each of their franchise communities. Notwithstanding claims to the contrary, there really is no effective competition to these cable operators. If you want clear broadcasting reception along with the variety of programming cable television has to offer, there is, for all practical purposes, just one player in virtually every town.

Today, the cable industry is taking advantage of an unparalleled, favorable, legal environment endangering the continued viability of free, over-the-air television in this country and blatantly riding roughshod over the wishes of consumers. Ironically, deregulation with its usual pro-consumer motivation, when applied to the cable industry has resulted in just the opposite effect. Cable operators who now have financial interests in the cable programming they carry have strong economic incentives to conduct their business irrespective of demonstrated consumer preference and to the detriment of the broadcast industry. Congress needs to take immediate steps to restore a "level playing field" on which local broadcast stations and cable can fairly compete.

## II. ANTITRUST/COMPETITIVE FRAMEWORK

### A. Cable Companies are Competitors of Local Broadcasters

Today, cable companies not only own the cable delivery system, but also own numerous programming channels. For example, TCI, the largest cable company, owns or has a significant interest in Turner Broadcasting (CNN) (WTBS), Cable Value Network (Homeshopping), The Discovery Channel, Black Entertainment, American Movie Classics, Tempo, Netlink U S A, X Press, QVC and Fashion Channel.

Cable companies compete with local stations to capture the local audience's viewing attention (consumers). Based on that viewing level, what we call "ratings", cable companies compete with local broadcasters for national and local advertising revenue. Because many cable companies may operate in a single geographic television market, they often enhance their competitive efforts in that market by banding together to sell, in concert, advertising on the cable channels they jointly carry on their respective systems in that market. These combinations are called "interconnects."[1] In short, cable companies control the access to the viewer while having financial interest in the delivery of competitive programming.

### B. The Cable Companies Possess Enormous Market Power Over Television Viewers and Broadcasters

Virtual 100 percent of the cable systems in the cities and towns of this country are local monopolies. Less than one percent of the communities in the United States have overbuilds (that is, more than one cable system), and even then, almost none of those communities has cable systems which actually compete with one another in the same neighborhoods of that community. As a result of its "gatekeeper" position, each local cable system has the power to decide what the viewers in that community can and cannot receive on their T.V. set without regard to consumer preference. And, through their channel placement practices, cable companies, regardless of consumer preference, decide how convenient or inconvenient it will be for those viewers to find the programming of a competing local broadcaster on their cable system.

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[1] Interconnects are important because they function as an economic deterrent to overbuilding in a cable company's neighboring area currently being served by a partner in the interconnect.

To the extent that there is no competition to the cable company and given its gatekeeper status, the marketplace is distorted. Viewers use the cable as a convenient means to gain reasonably clear access to local over-the-air programming as well as viewing the other cable offerings. Nevertheless, while 50 percent of the television households in America now rely on cable, at any given time the vast majority of those cable viewers are watching the over-the-air broadcast channels. As time has shown, cable companies prefer to eliminate or disadvantage their competitors by exercising their gatekeeper power, rather than having to compete against them in the marketplace.

### C. Even With Must-Carry, the Cable Companies Have an Established Record of Misusing Their Power to the Detriment of Consumers

Even while the must-carry rules were in effect, cable companies began to reshuffle channels of local broadcasters. This continues despite clear consumer preference for the local broadcaster's fare over the cable channel which replaced it. I know of no channel repositioning that resulted in anything other than a local station being moved out by a lesser-viewed cable program. The local station was either dropped or moved to a higher channel. Consumers who were accustomed to viewing that local station on its prior channel were disadvantaged or even displaced if their T.V. set could not receive the higher channel on which their preferred programming now appears.

Now that TCI has given its go-ahead to the new TNT Channel, local broadcasters fear for their very existence. Will they be moved or replaced to make room for this new TCI program venture? An overwhelming economic incentive exists for the cable operator to replace the local station from which it derives no direct revenue, with either a cable channel in which it owns an equity interest, a cable channel on which it sells advertising, or a cable channel from which it derives money or other forms of direct compensation. In short, the cable companies as local monopolists, can afford to place consumer wishes regarding programming and dial positions second to those companies' own direct economic interests.

Often the cable companies publicly rationalize their channel positioning decision based on "consumer surveys" -- surveys which are of highly dubious reliability and often are contrary to readily available consumer preference evidence such as existing rating service data provided by Nielsen and Arbitron.

Cable's cavalier channel repositioning efforts reached their height when some cable companies in effect auctioned channel position to the highest bidder among cable networks. It worked like this: A cable network would say, "our programming normally costs X. If you move us to channel 2, we will charge you X - Y or less." The distorted marketplace gives cable companies not only the incentive but the economic power to do this. But there is clear injury to competition when a cable system uses its monopoly power and control over the delivery system to disadvantage its competitor in the face of clearly demonstrable consumer preference for the local broadcast station. Regardless of consumer preference, cable companies prefer to position the cable programming in which they have a financial interest on the lower tier (2-13). Typically, they end up relegating many local broadcasters to "Siberia" on the television dial.

On occasion, cable companies "offer" to move local broadcasters to cable channel positions which match the broadcasters' over-the-air designations. For some stations this may be acceptable, but for others a move of this nature is tantamount to being dropped from the system entirely. For example, some cable companies like TCI do not automatically give subscribers with second sets a converter box when they hook up that second T.V. set. If the second set is not cable-ready, and virtually all are not, and if the station was moved out of the 2-13 channel range, it is very unlikely that that station can be received on that second set.

Companies such as TCI turn the argument on its head when they attack the local station for demanding better positioning than its over-the-air dial position. We see it differently. We are not demanding an upgrade, just don't downgrade us if consumers prefer what we do over what you own. That is, unless TCI can show reliable consumer preference data for the programming it seeks to use to unseat a local broadcaster from its long-held channel position, TCI does not have the legal right to act contrary to consumer preferences in the environment of a distorted, monopolistic marketplace wherein it derives a financial benefit from uprooting the local stations.

By definition, such a move is not in the consumer interest if consumers preferred the uprooted local station to the newly installed cable channel. Such behavior is in the interest of the cable company monopolist, not in the interest of consumers.

### D. With the Elimination of Must-Carry and Pursuant to Their Anticompetitive Agenda, Cable Companies Will Now Use "Editorial Judgment" as a Subterfuge to Unfairly Compete Against Local Broadcasters

Misconduct occurred during the must-carry years. With the elimination of must-carry, anticompetitive behavior on the part of the cable companies will accelerate to the detriment of clear consumer preferences and to the detriment of the local broadcasters. The delivery system will be used by cable companies as an anticompetitive device which need not be responsive to consumer wishes while it anomalously reaps ever higher and higher profits. Only in an abusive monopoly climate can an entity earn more and more money not being responsive to consumers.

A broadcaster is largely powerless to fight the cable operator's decision to favor cable channel programming over broadcast programming. The broadcaster cannot realistically expect viewers to forego cable service to protest the deletion of a single broadcast station. First the cable companies went after the public stations. Now they are taking on the local stations one by one. And even when viewers do object, cable companies do not respond. They say, "Too bad, it's our system." Absent government regulation, the cable operator's monopoly position allows it to maximize profits while offering a less than optimal service to the viewers.

Significantly, one means that local stations might use competitively to maintain or entice carriage by a cable system on an attractive channel is for the local broadcasters to offer exclusive programming which consumers/subscribers would want to see. But the compulsory copyright law which Congress enacted, especially without strict syndicated exclusivity, has deprived local broadcasters of this most important competitive tool.

## III. COMPULSORY COPYRIGHT -- ELIMINATION OF SYNDICATED EXCLUSIVITY -- OVERTURNING OF MUST CARRY AND THE 1984 CABLE ACT HAVE CREATED AN IMBALANCE ENABLING CABLE TO PROFIT CONTRARY TO CONSUMER WISHES AND TO THE DETRIMENT OF COMPETITIVE FORCES AND THE BROADCASTING INDUSTRY

The 1976 Copyright Act and the 1984 Cable Act (together with the elimination of the FCC's syndicated exclusivity and must-carry rules) have left a dramatic imbalance in the respective rights of broadcasters and cable operators. Congress created cable's compulsory copyright license in 1976 to assist the fledgling industry's access to programming at a time when the cable industry argued it could not afford to negotiate for or acquire programming on its own. Instead of having to negotiate for this valuable programming, cable was given the statutory right unilaterally to appropriate broadcast programming in exchange for relatively trivial payments. With one company projecting a 1988 cash flow of $1 billion, this special copyright treatment makes no sense today -- the cable industry surely has the resources to bargain for its programming like any other copyright user.

The operation of cable's compulsory copyright license is particularly harmful to broadcasters because, under current conditions, it facilitates cable's importation of duplicate programming without regard to licensing agreements negotiated between program suppliers and local broadcasters. Television stations today routinely find that they have spent millions of dollars securing the exclusive right to show a syndicated program in their respective communities, only to discover that the local cable operator is importing several distant signals showing the exact same programming, often in the same or adjacent time periods. Certainly it cannot be said that viewers prefer to see the same programming on different channels. Yet, cable has an incentive to import this duplicative programming. By doing so it fractionalizes the local station's audience and thereby causes the local station to receive less revenue. That leaves more revenue for cable to go after. Furthermore, the fractionalizing of local station's audience will result in lower ratings for that station. As a result, traditionally low cable ratings will by comparison look slightly more competitive. Again, the delivery system is being manipulated and used as an anticompetitive device.

Cable's ability to duplicate the programming of local stations is not something cable bargained for. Rather, it is a Congressional gift.

Cable is able to secure local exclusivity for the programming it places on cable channels; local broadcasters should have that same right. So long as that right is denied, local broadcasters are denied the ability to effectively compete with cable. The compulsory copyright and lack of a strict syndicated exclusivity provision enables cable to circumvent privately negotiated program contract exclusivity provisions and undermine the efforts of local broadcasters to make themselves more attractive and competitive. There no longer exists a satisfactory rationale for this disparate treatment of competitors operating within the same marketplace, especially in light of the damage it does to local broadcasters who continue to search for creative ways to remain competitive while bringing diversity to the viewing public.

The operation of the compulsory license is especially damaging to local broadcasters because, absent the FCC's old must-carry rules, cable systems can completely bypass local broadcast stations and rely instead on imported signals. There are no rules in effect today requiring the carriage of local broadcast signals, even as a condition to compulsory copyright licenses. Thus, when a cable operator finds it in its own financial interest to drop a local station, there are no readily available legal means to prevent it from doing so.

This problem is exacerbated by the cable industry's insistence that congress intended in adopting the Cable Act, to preclude interference, by either the FCC or local franchise authorities, regarding any cable-related decision.

In court case after court case, cable continues to attempt to escape whatever regulatory burdens it still faces on the grounds of the First Amendment.

When faced not only with proof of outrageously predatory conduct by a would-be competitor in its market, but also with objections from the franchising authority and the viewing public that it was supposed to serve, TCI Cablevision, in a celebrated court case, had the audacity to argue that its predatory conduct in trying to exclude competitors and ignoring consumer wishes was immunized by the First Amendment because TCI was engaging in "speech" activity. Both the jury and the trial court rejected that claim and TCI ended up paying more than $40 million in damages.

Cable companies also rely on two appellate court decisions involving must-carry to argue for First Amendment immunity for any and all of their activities related to program carriage, yet neither of those decisions even addresses -- much less decides -- issues of anticompetitive behavior by cable companies.

Cable companies around the country have attempted to convince courts they are even immune from state antitrust law and consumer protection statutes. For example, only a few weeks ago a case brought by West Virginia addressed the threshold Cable Act preemption issue in the context of a jurisdictional motion to dismiss. West Virginia claimed that Capitol Cablevision, an American Television and Communications Corp. ("ATC") subsidiary, violated West Virginia consumer protection and state antitrust laws. ATC claimed the Cable Act preempted state law. Fortunately, this judge disagreed.

Meanwhile, other trial courts have begun to severely restrict the powers of local governments to provide some check on the market power of cable companies. One court even went so far as to state that the purpose of the Cable Act was to foster the growth of cable -- as if cable were still a fledgling industry.

Contrary to viewer preference, consumer interests and antitrust and unfair competition statutes, cable companies will use a combination of the Cable Act, court decisions and the First Amendment to assert the proposition that they have carte blanche to do whatever they want regardless of the injury to the consumers and the competitive process.

Congress needs to focus its attention on the cable companies and recognize that cable companies act out of greed and not in the public interest or the consumers' interest.

Our experience, which follows, is both not unique and unique. Not unique insofar as the treatment we have received from cable companies. Unique in that we have elected to fight, to commit the necessary resources, and to draw the line. Fortunately, we can afford it. Other stations cannot and consumers are being manipulated by a cable shell game of dropping and moving stations contrary to clearly demonstrable consumer preferences.

With the elimination of must-carry and the introduction of new cable channels coming on each week begging for carriage, it is only a matter of time before wholesale dropping of local stations begins.

## IV. KBHK'S CABLE RELATIONSHIP

Long before it became "fashionable" for a local broadcast station to work with cable companies, KBHK in the 1970s recognized that local broadcasters and local cable companies shared a symbiotic relationship. San Francisco, known for its hills, was one of the early high cable penetration television markets. During this period, cable merely retransmitted the existing television stations' signals. And, in this period, Bay Area cable companies and KBHK were not competitors.

KBHK, however, was carried on an array of different cable channels throughout the Bay Area. A decision was made to try to persuade cable companies to move KBHK to one unified television market-wide cable channel. Cable 12 was chosen even though on many systems KBHK was carried on lower numbers. Also, at this time most cable systems were limited to 12 channels. KBHK believed that if it could successfully unify itself on virtually all Bay Area cable systems, it could advertise its over-the-air channel with its cable channel and over time develop a dual identification.

To achieve this goal, KBHK hired a full-time employee. This person sought to educate cable operators as to how popular KBHK's programming was with viewers. From time to time KBHK promoted the benefits of cable subscribership. KBHK often paid to advertise local cable companies on billboards. KBHK also bought technical equipment for cable companies to effectuate the station's move to channel 12.

To unify KBHK on channel 12 was no simple task. There were more than 65 Bay Area communities then served by more than 40 cable companies. Nevertheless, unification of KBHK on virtually all Bay Area cable systems was achieved. Almost 90 percent of all cable subscribers in the Bay Area received KBHK on channel 12.

With this level of success, KBHK launched a massive identification campaign to identify itself as "Bay Area Cable 12." KBHK became so identified as "Bay Area Cable 12" that this later became a registered tradename of KBHK.

In the early 1980s cable companies began to realize success in offering cable exclusive programming. This opened the way to competing for viewers and advertising revenue against such local stations as KBHK. This changed their historical relationship with broadcasters from one of interdependence to one of being competitors for viewers, advertising revenue and syndicated programming.

In late 1986, KBHK began to hear rumors about a market-wide cable channel repositioining plan by all cable companies in the market. Further investigation proved that the rumors were valid, and that KBHK was slated to be moved from its long-established Channel 12 slot to an undisclosed position way up the dial.

While KBHK obviously is aware of the benefits of channel unification, KBHK was already unified. Nevertheless, we were destined to be moved to "Siberia." This, despite the fact that KBHK is a very heavily viewed station: Viewed much more than any cable channel that might be offered to the public as a replacement.

Years of unification, advertising, Bay Area Cable 12 identification, and providing the public with preferred programming, were about to go down the drain. Moreover, viewers who preferred to watch us on Channel 12 might not be able to continue to view us if we were moved to a channel their particular television set could not receive.

But the most bizarre aspect of all this is that, in the name of market unification, cable companies were intent on uprooting KBHK which was unified _already_. The only reason for doing this was obvious. It was for cable companies' economic benefit and not for the benefit of consumers, who had clearly demonstrated they prefer our programming, and who have long expressed a preference for the popular local stations to be grouped together on the low end of the dial.

In the face of this market-wide unification attempt, KBHK first tried to impress upon 25 local municipalities that they,under their various franchise agreements, could protect local consumer preferences as to channel placement. The cable companies with their expensive lobbyists and lawyers stormed the City Halls waving the Cable Act, First Amendment and threats of suits against the cities if they did anything of the sort. The cities were clearly intimidated by the cable companies' efforts. Thereafter, we examined our options and, ultimately, KBHK elected to bring a suit in state court for injunctive relief alleging violations of state consumer protection statutes in the form of antitrust violations and unfair competition violations.

At this time KBHK and the named defendant in that suit have resolved our respective differences and are attempting to work together in a productive manner exploring ways to enhance the symbiotic aspect of the relationship that still exists.

While KBHK's cable channel shifting circumstances appear to be headed in a productive direction, the problems are far from over. In late 1986, the world's largest cable company, TCI, notified us that we would be moved from Channel 12 to different, higher channels on their six Bay Area systems. By January 1986 we were moved on all six of these systems. On five of the six systems TCI's owned Discovery Channel took our place. TCI owns a substantial equity interest in this cable programming and also derives advertising revenue from the commercials sold in the program. This move was contrary to demonstrable viewer preference and TCI admitted to throwing out more than 90 percent of the results of its own "consumer survey" on what viewers wanted regarding channel placement. As of a month ago, we began to receive viewer complaints from one TCI system that the channel they moved us to often experiences cable technical interference difficulties.

TCI has for the last year refused to address itself to this matter and currently we are exploring all of our options. We are damaged by TCI's behavior which is not based on consumer preference, and we continue to suffer harm. While viewers may not even be able to receive the programming they prefer, TCI nevertheless gets richer and bigger.

In the Bay Area, KBHK is the only local station that buys advertising space in the multiple cable companies' cable guides.

After we brought our lawsuit and without naming United Cable or Gill Cable to that suit, both companies declined to accept our advertising. Moreover, United Cable, which imports a distant UHF signal from Sacramento which often duplicates much of the same programming KBHK airs, lists the Sacramento station in its Bay Area cable guide, but does not list KBHK. This is true even though KBHK enjoys a far higher viewing level than that imported signal.

Both United Cable and Gill Cable are TCI companies or will become TCI companies by 1991.

Cable companies are motivated by profit. So are local broadcasters. The difference is that because they are monopolists, cable companies have found ways to enhance their profits without being responsive to the consuming public while at the same time injuring their competitors.

## V. CONCLUSION AND RECOMMENDATION

Cable is a competitor of local broadcasters. It uses its monopoly power over the delivery of programming to unfairly compete with local broadcasters for viewers (which translates into competing for advertising dollars). This results in an anomalous economic gain to the cable companies while consumers are denied their viewing preferences. Consumers and local broadcasters are being harmed by cable companies' unfair competition.

Congress needs to specifically:

A. Investigate cable's increasing concentration of power at both national and local levels and how it abuses this power.

B. Amend Cable Act where necessary to protect consumers and local broadcasters from cable's anticompetitive and predatory behavior.

C. Tie the compulsory license to must-carry and syndicated exclusivity.

D. Prevent channel shifting without a clear cut showing of consumer preference.

[John Siegel submitted additional documents with his testimony which may be viewed in the Antitrust, Monopolies and Business Rights Subcommittee upon request.]

Senator METZENBAUM. Thank you, Mr. Siegel. Mr. Siegel, if you hear of a scintilla of evidence of retribution against you, do not call my staff, call me.

Mr. SIEGEL. Thank you, Mr. Chairman.

Senator METZENBAUM. I want to know about it the next day.

Mr. Chapman, how realistic is the possibility that in the next few years events like the Rose Bowl or the World Series or the Academy Awards, that millions of Americans now can watch on free TV, will become available only over cable?

Mr. CHAPMAN. Mr. Chairman, I think the possibility of that happening is very great. I would see it first to take place probably in sporting events. Had it not been for the bidding turning out the way it did for the Sunday night football, it could very well have been on pay cable this year, the NFL. And that was a 3-year contract and you may very well see when that contract is up, I would see extensive negotiation for those rights by cable.

Mr. MALTZ. Mr. Chairman, if I may respond to that question as well? A president of a rather large broadcast company who was trying to bid for the broadcast right for those Sunday night games called me and said he was being discouraged from bidding. And he knew that I was a friend of an owner of an NFL team, would I make a call and find out what the problem was?

I made that phone call and I was told that those Sunday night games were designed because people would pay little, scant, attention to a Sunday night football game. It was their chance to get on cable. They did not want broadcasting to be involved regardless of cost. It was the beginning of movement toward pay TV. Even if it took 5 or 10 years, this was the beginning.

Senator METZENBAUM. The Chair has asked the antitrust division of the Department of Justice to inquire into the matter of the NFL games being—the ESPN contract with the NFL. The Chair has very serious concerns about that. The Chair very well may expand the area of that inquiry into other sports events as well.

Mr. Maltz, you attach a number of press clips to your testimony reporting plans that a number of Ohio cable companies had in late

1986 to drop a number of independent and public television stations. Did the announced drops actually occur? And do you know what impact that had, if it did occur, on the stations involved?

Mr. MALTZ. The announcement was made and it was carried in all the newspapers and there was a tremendous response by citizens. But apparently there was no response by the local cable operator. I personally made a trip to Denver to meet with Mr. John Malone, chairman of TCI, and persuaded him to leave well enough alone.

So, in fact, it did not occur, but they did make the announcement that it was going to occur. It was our station, another station or two in Cincinnati, a PBS operation and several Dayton stations. They were going to bring in distant signals such as WGN in Chicago.

Senator METZENBAUM. Some have raised the question as to whether or not the free TV stations should be paying cable to carry your signal. Is that an alternative?

Mr. MALTZ. Well, sir, let us put it this way. At the present time, we are paying millions of dollars in copyright fees. They are carrying our programming and paying nothing. It seems to me that is a one-way road. We cannot continue in business like that.

I have been advised by one cable operator, "it is only a matter of time before we are going to charge you for carriage."

Look at it another way. The owners of the software companies such as ESPN and the other program services do offer a discount on their charges to the local hardware dealer, the local cable operator, in exchange for better program location, such as the lower tier of channels. Since we are giving our service away for nothing, how can we offer a discount?

Senator METZENBAUM. Mr. Triplett, how much of your programming is of local interest? Have you done anything——

Mr. TRIPLETT. We have provided a considerable amount of local sports like high school basketball in Columbus, going from a different game every week to give coverage of the city, plus melting Chillicothe into that matter. And we also did a football game last fall. This coming fall we expect to do a full football schedule locally and a full basketball schedule locally.

We are commencing a local newscast in about 1 week. As you probably know, sir, it is very expensive for a new entity to start news right away. We are initiating that in about 1 week.

Senator METZENBAUM. Since you were dropped by Coaxial Cable, have your ratings dropped?

Mr. TRIPLETT. I am sure they have, sir. And an even more deleterious effect is with your advertisers. Because when you are dropped from that many or that large a percentage, about 30 percent, it is a serious problem out on the street for the sales people.

Senator METZENBAUM. How many viewer complaints, Mr. Siegel, have you received since the TCI cable systems in the Bay Area moved you to a different number?

Mr. SIEGEL. Quite a few.

Senator METZENBAUM. Have your ratings been affected?

Mr. SIEGEL. The ratings have been affected. There have been quite a few consumer complaints, both telephone calls and written complaints. And only last month, Mr. Chairman, I received a tape from a consumer/viewer in Redwood City wherein he says that he wanted us to know that our signal is being degraded on this newly moved channel that TCI moved us to.

In other words, the channel that they moved us to, the signal is degraded. That TCI has not responded to correcting this problem, and that basically TCI has sloughed him off. He sent me a tape. We have herringbones all over our programming.

Senator **Metzenbaum**. I want to thank this panel for cooperating with us and all the members of the panels. You know, I have been here long enough—I came here from the business world. And I think from the day I came here until today I constantly here the plaint of the business community to get the Government off our backs, keep Government out of free enterprise. I was in the business community and I understand that approach.

But this hearing today has pretty well convinced me that unless the industry itself does some things to correct its own activities and to get its own house in order, that the only possible solution is for Government to intercede. And I believe, as I said earlier, that unless that does occur Government will intercede and the Chair of this committee will not be bashful in providing that leadership in order to facilitate such intercession.

I would hope that would not be necessary. Within 60 days we will take another look at the industry, whether by public hearing or on our own, and we will arrive at a conclusion at that point as to whether or not we believe that legislation is an appropriate action to take.

I am very much disturbed at the threat to the free television industry, at the increase in rates that have occurred in some areas which would be appear to be excessive, and to the unavailability of product to those who are in the wireless TV end of the industry. This is not the conclusion of this subject today, it is only the beginning.

[Information for the record follows:]

ML

MICHIGAN STATE UNIVERSITY

DEPARTMENT OF ECONOMICS • MARSHALL HALL
EAST LANSING • MICHIGAN • 48824-1038

March 8, 1988

Eddie Correia, Esq.
Senate Antitrust Subcommittee
308 Hart Senate Office Building
Washington, D.C. 20510

Dear Ed:

Pursuant to our telephone conversation earlier today, I am enclosing herewith the Adams/Brock article on recent developments in the video entertainment industry.

I shall be pleased to have you include this article in the record of the hearings which Senator Metzenbaum plans to conduct on the subject, starting March 17.

With best wishes to the Senator and you, I am,

Sincerely yours,

Walter

Walter Adams
Distinguished University Professor

WA/gt

enclosure

MSU is an Affirmative Action/Equal Opportunity Institution

Los Angeles Times

Sunday, November 22, 1987 / Part IV 3

# Hollywood Independents Start to Feel the Squeeze

By WALTER ADAMS
and JAMES W. BROCK

The threat of monopoly is once again casting its shadow over the entertainment industry. Major players in the industry—movie studios, theaters and the cable, pay and broadcast television networks—are caught up in a maelstrom of mergers and acquisitions, combining operations at the industry's three pivotal stages: production, distribution and local exhibition.

Consequently, vertically integrated giants have been established with the market power to thwart competition. The big companies can make it difficult both for independent producers to market their work and for independent exhibitors to get these productions. It is the kind of monopoly power that the Supreme Court in 1948 decided to neutralize by ordering the Big Five (Paramount, Loew's, RKO, Warner Bros. and 20th Century-Fox) to divest either their production-distribution operations or their exhibition outlets.

Today, the 1948 defendants are intent on re-establishing their control of the full breadth of the industry. The top studios—which account for more than 80% of film production and distribution—are voraciously gobbling up theater chains. Over the last two years, motion picture studios have acquired 14 theater chains, representing 4,224 screens.

For example, Universal Studios purchased controlling interest in Cineplex-Odeon—one of the largest theater circuits in North America; and Cineplex, in turn, has purchased the RKO Century, Septum and Essaness chains, among others. Other major studios are doing the same. The recent turbulence in the stock market may put a temporary damper on this trend—the recent collapse of the proposed merger of United Artists Communications and United Cable Televi-

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**WALTER ADAMS** *is a professor of economics and past president of Michigan State University.* **JAMES W. BROCK** *is associate professor of economics at Miami University (Ohio). They are co-authors of "The Bigness Complex," which was published this year.*

sion is a case in point—but the long-term outlook is unchanged.

The studios also are acquiring local television stations: Fox bought Metromedia—the nation's largest chain of independent stations—as well as WXNE in Boston. Indeed, under the guidance of Rupert Murdoch, Fox is establishing a fourth national TV network. For its part, Universal has purchased TV "superstation" WOR, which reaches 8.4 million subscribers via 1,400 local cable-TV systems. In quick order, movie companies have come to own stations reaching an estimated 30% of the nation's TV homes.

Furthermore, movie companies now dominate the production of programming for broadcast television. Last year, the top studios accounted for 52% of all prime-time programming carried by the networks and 45% of all syndicated television programs.

The story is similar in cable and pay TV. Movie companies operate local cable systems. (Warner is the nation's sixth-largest operator of multiple cable systems nationally.) They also have substantial financial interests in cable programmers such as HBO, USA Network, Nickelodeon and MTV that distribute viewing fare to cable systems. And they have struck agreements to exclusively supply movies and programs to cable programmers and operators.

The movie firms are not alone in their frenzied efforts. Local cable-TV systems are being taken over and merged under centralized national control. According to Michigan State communications professor Barry Litman, the nation's largest cable system operator, Tele-Communications Inc. of Denver, has increased its empire from 1.3 million subscribers in 1981 to more than 7 million today. The combined share of the top two multiple operators doubled between 1982 and 1986. At the present rate of consolidation, the five largest cable operators may control nearly half the business by 1990—up from 29% in 1982.

Meanwhile, cable operators are also getting into program production and distribution. For example, Tele-Communications has acquired a sizable stake in Turner Broadcasting. For its part, Turner—which produces and distributes Cable News Network and other cable programs—has acquired MGM.

The TV networks are playing the game too. CBS is a part owner of HBO, while Capital Cities/ABC operates ESPN. In addition, the networks are demanding a relaxation of Federal Communications Commission rules limiting their ability to produce programs for their approximately 600 local affiliates.

**Pattern Is Emerging**

Finally, an intricate pattern of cross-media combination is emerging—a pattern that cuts across the entertainment field and binds it tighter. For example, the Columbia Pictures unit of Coca-Cola, CBS and HBO joined in 1982 to launch Tri-Star Pictures, a film production venture. HBO was assigned exclusive rights to exhibit Tri-Star movies on pay TV, while CBS got exclusive rights to broadcast Tri-Star films on network TV. (Now there are even bigger plans for Tri-Star: Coca-Cola announced in September that it would fold its Columbia, Loew's Theaters and Coca-Cola Television interests into Tri-Star, which will be renamed Columbia Pictures Entertainment.)

In sum, we are witnessing the re-linking of production, distribution and exhibition and the concentration of power across the whole spectrum of entertainment among fewer firms.

**Problem May Worsen**

Once again, this raises the vexing vertical monopoly problems of a half century ago: What will happen to the ability of independent producers to compete as distribution channels and exhibition outlets are constricted and concentrated in the hands of a few corporate giants? What will happen to the competitive position of independent exhibitors (theaters, local TV stations and local cable operators) as production, distribution and programming are concentrated in the hands of those same giants? Will competition be undermined as it was 50 years ago? And what will happen to the diversity and creativity of viewing fare, when a handful of vertically integrated firms dominate all these fields?

The outlook is not reassuring. The National Cable Television Assn. charges that "the Hollywood studios have seemingly deprived independent theater owners of the theatrical releases they need to survive," that they "have begun to collaborate among themselves to jointly operate theaters and to jointly decide which theaters get their film products," that "independent film makers are virtually shut out by the major studios from distributing their films to neighborhood theaters" and that independent television stations "have been injured by Hollywood's hardball tactics."

For its part, the Motion Picture Assn. of America voices its alarm that "extraordinary power wielded by the largest [multiple-cable owners] has created serious disruptions in the program supply marketplace that will only grow worse as the growth in cable ownership concentration continues."

Of the efforts by the TV networks to move into program production, MPAA President Jack Valenti warned: "If you turn these companies loose, they're going to organize a monopoly"—a warning also sounded by independent TV stations.

Perhaps, these charges and countercharges underscore the central problem of vertical monopoly. What if *all* of them are correct?

**ATTORNEY GENERAL**
**CHARLIE BROWN**

March 15, 1988
Contact: Marc Dann
304/343-8800

Statement

by

West Virginia Attorney General Charles G. Brown

Today, West Virginia Attorney General Charles G. Brown announced he is forming a multistate antitrust task force to investigate anticompetitive practices in the market for satellite delivered programming. General Brown made the announcement in Washington, D. C. where he was attending meetings of the National Association of State Attorney Generals (NAAG) from the Association headquarters.

General Brown chairs the NAAG Antitrust Committee where he has been a leader in pursuing vigorous enforcement of antitrust law. The task force assembled by General Brown includes five states: West Virginia, Ohio, Texas, New York and Maryland.

POST OFFICE BOX [illegible]
CHARLESTON, WV 25321

[illegible]

General Brown hosted a workshop meeting in the United States Capitol Monday night, March 14. The meeting was attended by Attorney Generals and staff from several states as well as key Congressional staff involved in upcoming cable television hearings.

"The workshop provided an opportunity for us to discuss whether there is adequate competition among cable, wireless cable, and other retail distributors of satellite-delivered programming," General Brown said.

General Brown commended Senator Howard Metzenbaum (D-OH) for holding antitrust hearings on this subject in Washington, D. C. on March 17, 1988. He also noted the leadership Senator John Kerry (D-MA) has exercised in investigating anticompetitive practices in the industry, such as recent wireline exclusivity proposals by programmers affiliated with big cable interests.

Last year, General Brown brought an antitrust action against a local cable television company operating in the State Capitol of Charleston. In the future, General Brown plans to develop an effective state-level strategy through his multistate task force and work closely with Congress as it addresses problems with the cable television industry.

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March 16, 1988

The Honorable Howard M. Metzenbaum
Chairman, Anti-Trust Subcommittee
Senate Judiciary Committee
Room 226 Dirkson Building
Washington, D.C.

Dear Chairman Metzenbaum:

On behalf of the Trinity Broadcasting Network, National Minority TV, Inc., All American TV, Inc., and Community Educational Television, Inc., I am enclosing their Joint Comments in connection with the March 17, 1988 hearing deliberations of your Anti-Trust Subcommittee. The commentors are nonprofit operators of independent UHF television facilities and their comments explain the anti-competitive, unfair and monopolistic activities of cable system operators, and the detrimental impact such activities have on free television, due to the District of Columbia Circuit Court's invalidation of the FCC's must-carry rules.

It is respectfully requested that these comments be incorporated in the Subcommittee's written record.

If any questions should arise please contact this office.

Respectfully,

Colby M. May

CMM:gmcB06/B78
xc: Nina Laury (308 Hart Building, Hand Deliver)
Mrs. Jane Duff
Dr. Paul F. Crouch
Cruz S. Arguinzoni
John DeS. Casoria

# MEMORANDUM

**TO:** THE HONORABLE HOWARD M. METZENBAUM, CHAIRMAN, OF THE ANTI-TRUST SUBCOMMITTEE OF THE SENATE JUDICIARY COMMITTEE

**FROM:** UHF TELEVISION BROADCAST OPERATORS TRINITY BROADCASTING NETWORK, NATIONAL MINORITY TV, INC., COMMUNITY EDUCATIONAL TELEVISION, INC. AND ALL AMERICAN TV, INC.

**RE:** JOINT COMMENTS ON THE MONOPOLY OF CABLE TELEVISION SYSTEMS AND THE DEMISE OF INDEPENDENT FREE TELEVISION

**DATE:** MARCH 17, 1988

These are the joint comments of the Trinity Broadcasting Network (Trinity), National Minority TV, Inc. (NMTV), Community Educational TV, Inc. (CET), and All American TV, Inc. (All American) (jointly, Commentors), all of which are nonprofit organizations operating independent UHF television facilities throughout the United States. Trinity and All American operate 12 and 4, respectively, full power independent television stations. These independent stations provide family oriented and religious programming with significant amounts of public affairs, informational, and public service programming.[1]

CET operates three noncommercial television stations, and provides educational, informational, public affairs, public service, and family oriented and entertainment programming.[2] NMTV is constructing its first television facility in Odessa, Texas (KMLM-TV). NMTV and All American are minority controlled corporations.

As operators of commercial and noncommercial television facilities, Commentors have experienced first-hand the far reaching and devastating impact caused by the effective demise of the "must-carry" rules in the wake of the District of Columbia Circuit Court's twin decisions in Quincy Cable TV, Inc. v. FCC, and Century Communications Corp. v. FCC.[3] Prior to the Court's ruling in Quincy Federal Communications Commission Regulations for over 25 years had required cable systems to carry all television stations licensed to communities within 35 miles of the cable system. These must-carry regulations survived several vigorous challenges, and the Supreme Court had even affirmed the FCC's authority to regulate cable television systems for purposes "reasonably ancillary" to the FCC's regulatory responsibilities toward broadcast television, including "must-carry."[4]

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[1]/ Trinity and its wholly controlled affiliates, operate stations: KTBN-TV, Santa Ana, California; KPAZ-TV, Phoenix, Arizona; WKOI-TV, Richmond, Indiana; KTBW-TV, Tacoma, Washington; KTBO-TV, Oklahoma City, Oklahoma; WTBY-TV, Poughkeepsie, New York; KNAT-TV, Albuquerque, New Mexico; WHFT-TV, Miami, Florida; WDLI-TV, Canton, Ohio; WLXI, Greensboro, North Carolina; and WCLJ-TV, Bloomington, Indiana. All American operates: KTAJ-TV, St. Joseph, Missouri; KDOR-TV, Bartlesville, Oklahoma; WWTO-TV, LaSalle, Illinois; and WTJP-TV, Gadsden, Alabama.

[2]/ CET operates KETH-TV, Houston, Texas; KLUJ-TV, Harlingen, Texas; and KITU-TV, Beaumont, Texas.

[3]/ 768 F.2d 1434 (D.C. Cir. 1985), cert. denied, 106 S. Ct. 2889 (1986); and Century Communications Corp. v. FCC, ____ F.2d ____, 64 R.R.2d 113 (D.C. Cir. 1987), respectively.

Following Quincy, the FCC voted unanimously on August 7, 1986, and again on March 26, 1987, that the health, even the survival, of a free over-the-air television service required the imposition on cable systems of modified must-carry rules.[5]

The FCC's post-Quincy must-carry rules were written with an eye to satisfying the Court's concerns expressed in Quincy and were at least partially the product of an agreement between the broadcasters, represented by the National Association of Broadcasters (NAB), and operators of cable systems (hereinafter Cable Operators), represented by the National Cable Television Association (NCTA). The new must-carry rules did not specifically require the carriage of all local stations, but rather created a "pool" of qualified local signals from which Cable Operators could select, up to a maximum quota of roughly twenty-five percent of the cable system's activated channel capacity. Nevertheless, even these modest must-carry requirements adopted with the acquiescence, even the active participation of the Cable Operators' largest trade association, were struck down by the Court in the Century case.

Since the Quincy and Century cases were decided, the Commentors have collectively been removed from over 10 cable systems serving numerous local communities with nearly 230,000 viewers. In some instances Commentors were removed from cable systems serving their communities of license, the communities which Commentors are obligated, by the terms of their FCC licenses, to serve (and failure by a television licensee to serve its local community could result in a loss of its five year renewal license). In addition, numerous cable systems, serving over 915,000 viewers, which were scheduled to begin carrying many of the Commentors' stations have in the wake of the Court's decisions unilaterally decided not to begin carriage of these local stations. These actions by Cable Operators have not only economically harmed the Commentors, and collectively the construction costs for Commentors' stations represent initial capital investments of over 30 million dollars, they have effectively denied the Commentors access to the public they are licensed and required to serve.

The demise of the must-carry rules has given Cable Operators the unlimited authority to choose the information which local viewers shall receive. Moreover, unlike broadcast stations, this unlimited authority is largely unregulated by the federal government and, since the Cable Communications Policy Act of 1984,[6] cable is subject to only the least intrusive state or local regulation. Nor are the Cable Operators subject to regulation by market forces since the compulsory copyright license[7] ensures that cable systems receive a majority of their product (programming) at a price set artificially low by government action, and whose only real potential competitors, in terms of capital assets and existing communications infrastructure, the telephone companies, are barred from competition.

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[4]/ U.S. v. Southwestern Cable Co., 392 U.S. 157 (1968); U.S. v. Midwest Video Corp., 406 U.S. 649 rehearing denied, 409 U.S. 898 (1972); and FCC v. Midwest Video Corp., 571 F.2d 1025 (8th Cir. 1978), aff'd, 440 U.S. 689 (1979).

[5]/ Amendment of Part 76 of the Commission's Rules Concerning Carriage of Television Broadcast Signals by Cable Television Systems, 1 FCC Rcd. 864 (1986), recon. denied, 2 FCC Rcd. 3593 (1987).

[6]/ 47 U.S.C. § 521-29.

[7]/ 17 U.S.C. § 111.

The demise of the must-carry rules, in conjunction with the Cable Communications Policy Act of 1984, the compulsory copyright license, and the prohibition of effective competition by banning telephone companies from the cable television industry, has allowed a federally and locally unregulated monopolist to function as a gatekeeper, deciding which broadcast stations have access to the communities they are obligated to serve. As stated by FCC Commissioner James H. Quello in his January 16, 1988 speech before the Alabama Broadcasters Association, no "monopoly or semi-monopoly transmission pipeline should be able to prevent or obstruct the licensed stations' local service to the public." Unfortunately, Cable Operators have rarely exercised their control over the information provided subscribers in the public interest, and the public has suffered accordingly.

Cable's gatekeeping power is bad enough. Incredibly, however, that power is also federally subsidized. Cable Operators enjoy a significant competitive advantage over the same local television stations whose access to the viewers it controls, since, under the 1976 Copyright Act, the cable system may carry a local station's programming free of charge, without copyright liability, programming for which the station paid competitive high prices. Cable Operators may then charge cable subscribers a monthly fee for the same programming it receives free of charge. Programming costs for independent stations are continuing to escalate, particularly for the exclusive broadcast use of syndicated programming. To make matters even more unfair, cable systems may telecast the same (duplicate) programming by carrying a non-local broadcast station. When that happens the cable system pays only a small fraction of the local station's cost for the same programming, since cable only pays an artificially low and federally set price reflected in its compulsory copyright fees.

As if these compounded advantages were not enough, Cable Operators also aggressively compete with local broadcasters for the same advertising and donor dollars which support free programming available to the public on commercial and noncommercial TV stations. As Commissioner Quello noted: "[t]he potential scenario for a no 'must-carry' communications market is nothing but disaster for local broadcast service and eventually for continued free major sports events and fine quality programs."

Both Congress and the Federal Communications Commission do a disservice to local broadcasters and violence to common sense in attempting to legislate or regulate on the basis of a theory of market competition that does not exist. The fact that dominates the communications marketplace is that, for cable television, there is no marketplace. Cable television systems, once franchised, have no effective competition. Absent must-carry rules cable systems are monopolies with no limit on their discretion concerning the information which they choose to provide subscribers. The Cable Communications Policy Act of 1984 even denies local or state authorities the traditional tool used to regulate monopolies--rate regulation.

While the FCC's post-Quincy must-carry rules had provided for an input selector switch (the A/B Switch) to permit cable subscribers to be able to switch from cable to over-the-air television, this requirement was vigorously opposed by the cable industry. Even if the A/B Switch requirement were resurrected in some manner as a supplement or substitute for must-carry, it would provide little, if any, practical relief to local broadcasters. With the up to 104 channels available on cable with superior reception, the subscriber's incentive to install an A/B Switch to receive (if at all) an off-the-air signal on an indoor antenna would be negligible.

The demise of the must-carry rules also distorts, to the monopolist's benefit, the economic relationship between competitors for ever scarcer advertising dollars. Make no mistake about it, the economics of advertising make local broadcasters and the cable systems competitors for advertising dollars, and create an economic and competitive rationale for denying local broadcasters access to the audience they are licensed (obligated) to serve. Since cable subscribers must pay a monthly fee, they are, almost by definition, a more affluent market segment than that available to free over-the-air television. When a cable system is able to function as the "gatekeeper" it may effectively monopolize for itself advertising dollars aimed at more affluent demographics, leaving the system's broadcast competitor with no access to the more desirable and more saleable demographics. Prevented, or at least hindered, from competing for advertising dollars, the economic structure supporting free over-the-air television is further dangerously weakened.

In view of the new economic universe in the 1980's, and the overwhelming competitive advantages enjoyed by cable systems, federally mandated programming subsidies, such as the compulsory copyright and the lack of syndicated exclusivity, which artificially limit the price paid by cable system's for programming, are unnecessary, uneconomic, anti-competitive and contrary to the public interest.

For a local broadcaster, the cable system may telecast its programming without any cost at all. For syndicated programming provided by distant stations, the compulsory license permits cable to take and retransmit broadcast programming without express permission and without regard to the contractual arrangements the broadcaster may have made concerning program distribution. A cable system need only pay the copyright rate periodically set by the fiat of the Copyright Royalty Tribunal. Whatever rationales justified the copyright license, such as the need to foster the infant cable industry, have clearly passed away over the last 12 years.

Any concern that cable would be unable to handle the transaction costs of negotiating directly with copyright holders simply does not apply today. Cable has proven itself capable of negotiating for cable program services. In fact, cable already negotiates for three out of four program services it receives, as is certainly appropriate for a monopoly which controls program distribution to the most significant markets.[8] Without must-carry, cable's compulsory license significantly distorts the cost of programming, depriving copyright holders of significant revenues. Cable systems should buy and sell programming in a market bereft of such artificial and anti-competitive subsidies.[9]

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8/ 39 Federal Communications Law Journal 119 (May 1987).

9/ Primarily due to the vigorous arguments of cable, the Cable Communications Policy Act of 1984 cleared the way for Cable Operators to compete in an unregulated marketplace and deregulated its basic rate structure. On the other hand, Cable Operators vigorously defend the compulsory license--a license which insulates Cable Operators from paying the market price for programming. The cable industry should not have it both ways.

To summarize, the cable monopoly, in the absence of any must-carry obligations, has unfair trade advantages compared to broadcast television in the acquisition of programming, in the sale of advertising, and in the limited competition it must face. These anti-competitive advantages are magnified when Cable Operators may act as a gatekeeper in determining which of its potential competitors may have access to the community they are licensed to serve. Economic equity, not to mention the restoration of a more level playing field in an economic marketplace which has been tilted almost entirely in cable's favor, requires that at least some of the advantages Cable Operators enjoy must be removed. The gatekeeper, which under the current law retains many economic incentives to keep the gate closed, should be required to loosen its control of the gate. The only effective way for this to be done is to reinstitute the FCC's traditional must-carry rules. In addition, and at a minimum, the compulsory copyright license should be altered to reflect the real economic world in which cable and broadcast television compete to obtain and distribute programming.

Respectfully Submitted,

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John DeS. Casoria, President

LESEA BROADCASTING

March 17, 1988

Honorable Howard M. Metzenbaum
Chairman
Subcommittee on Antitrust,
Monopolies and Business Rights
Senate Judiciary Committee
Washington, D.C.

Re: Submission for Record of March 17, 1988 Hearings on Competitive Issues in the Cable Television Industry.

Dear Mr. Chairman:

On behalf of LeSea Broadcasting, Inc. ("LeSea"), I appreciate having this opportunity to inform the Subcommittee of severe anti-competitive conditions adverse to the public interest existing in today's cable television industry, particularly in the Tulsa, Oklahoma television market. LeSea Broadcasting, Inc., the broadcasting division of Lester Sumrall Evangelistic Association, currently owns and operates four television stations in Indianapolis and South Bend, Indiana; Honolulu, Hawaii; and Tulsa, Oklahoma. These stations are licensed by the Federal Communications Commission as commercial stations, but they differ from other commercial stations in that they offer specialty programming, primarily religious in nature.

KWHB-TV, Channel 47 in Tulsa, Oklahoma, is one such station, acquired by LeSea in 1986. The Tulsa television market is the 52nd largest television market in the United States with approximately 460,000 television households according to the 1985-86 Arbitron Television Markets and Rankings Guide, and approximately 51% of those households subscribe to cable television. There are six commercial television stations in the Tulsa market, including KWHB, and one non-commercial station, all of which are now carried on the local cable system at least part-time, except KWHB. KWHB has never been carried on the cable system serving Tulsa.

In June 1971, the City of Tulsa granted a franchise to Tulsa Cable TV, Inc. ("Tulsa Cable"), which now operates the only cable system in Tulsa. As of April, 1987, the Tulsa Cable system was the 13th largest cable system in the United States, wholly owned by United Cable TV Corporation ("United Cable"), the 7th largest multiple system operator ("MSO") in the country, with Tele-Communications, Inc., ("TCI"), the country's largest MSO, holding a large share of stock in United Cable. Last week, United Cable announced that it reached an agreement to merge with United Artists Cable Television Corporation, to create United Artists Entertainment Company ("UAE"), an entity which would be the nation's third largest MSO, with TCI as the controlling shareholder.

In 1987, Tulsa Cable served over 140,000 subscribers in fourteen different Oklahoma counties, more than 25% of all cable subscribers in the state of Oklahoma. Many of Tulsa

Cable's subscribers receive television service exclusively through the cable system because off-air reception of television signals is not possible. These households either lack access to a rooftop antenna or their television sets are not equipped for both cable television service and off-air reception. Tulsa Cable is the "gatekeeper" of a monopoly, bottleneck facility for advertisers, local television stations, and other programming sources that seek access to this significant part of the local television audience which consists of captive consumers who can only receive television service through the Tulsa Cable's system. KWHB's broadcasts cannot reach this audience, unless Tulsa Cable carries KWHB's signal on the system.

Prior to the time that KWHB commenced operations, the Federal Communication Commission's rules would have mandated the carriage of KWHB as a local television station on the Tulsa Cable system. However, in 1985, those rules were found to be overbroad under the First Amendment by the U.S. Court of Appeals for the D.C. Circuit. Subsequently, under intense Congressional pressure, the FCC reluctantly reimposed interim rules in 1987 to require the carriage of only some local television signals for a 5 year period. Recently, those rules were found to be unconstitutional, and all that remains in the way of federal regulation is a program for the dissemination of "input selector" switches, devices which are optional equipment for cable subscribers, incompatible with remote control devices, and which facilitate cable subscriber access to off-air reception only in instances where subscribers opt to have them installed at their own expense, and where subscribers have access to adequate antennas for off-air reception. Currently, Tulsa Cable enjoys complete discretion to decide which local television stations will be carried on the system.

As the only local television station in Tulsa without cable carriage, it is becoming more and more difficult for KWHB to attract and to satisfy programmers and advertisers. Accordingly, KWHB has determined that carriage on the Tulsa Cable system is indispensable to its survival as a television station in the Tulsa market. On numerous occasions, KWHB has requested carriage on the Tulsa Cable system and Tulsa Cable has refused to carry KWHB. Recently, KWHB requested access under the leased access provisions of the Cable Communications Policy Act of 1984 (47 U.S.C. § 532), and was refused the opportunity to lease a channel. In addition, aside from leased access under the Cable Act's provisions, Tulsa Cable refused to discuss the carriage of KWHB on the Tulsa Cable system on any terms. It appears that Tulsa Cable will not carry KWHB on the Tulsa system under any circumstances.

The reasons why Tulsa Cable has flatly refused to carry KWHB and has declined to negotiate the price of carriage, are readily apparent. Tulsa Cable is in direct competition with KWHB, by offering its own cable religious channel on the Tulsa Cable system. Tulsa Cable offers time on this religious channel to various religious programmers and advertisers, including many who would ordinarily purchase time or advertisements on an over-the-air broadcast television station such as KWHB. Essentially, Tulsa Cable deliberately excludes KWHB from its system and thereby forces religious programmers and advertisers to choose between circulation in cable homes on Tulsa Cable's religious channel, and circulation in non-cable homes on KWHB. If religious programmers or advertisers want to reach the audience in Tulsa's cable households, they must place their programs and advertisements on the Tulsa Cable religious channel. Moreover, because KWHB can only sell circulation in non-cable homes to advertisers, Tulsa Cable has placed a "ceiling" on the rates which KWHB may charge its advertisers, and made KWHB a limited distribution medium in the Tulsa television market. This severely impairs KWHB's ability to compete not only with Tulsa Cable's religious channel, but also with other broadcast television stations in the Tulsa market which are carried on the Tulsa Cable system.

Tulsa Cable attempts to justify its decision not to carry KWHB by indicating it does not want to duplicate programming already on the Tulsa Cable system. However, the only duplication which could occur on the Tulsa Cable system if KWHB were carried involves a small amount of religious programming and a small amount of syndicated programming to which KWHB purchases exclusive rights for the Tulsa market. Tulsa Cable currently offers 3 music channels, 2 Super channels, 2 children's channels, 4 news channels, and 4 premium movie channels, but only one religious channel. Ironically, Tulsa Cable explains its decision not to carry KWHB by stating that it prefers to avoid duplication in the types of programs offered on the system.

Several national religious programmers have chosen Tulsa Cable's religious channel rather than KWHB. Information about the rates which Tulsa Cable charges these religious programmers for access to its religious channel was unavailable. However, it is conceivable that Tulsa Cable could charge little, or nothing, to carry this national religious programming. Under Section 111 of the 1976 Copyright Act, Tulsa Cable enjoys a subsidy in the form of a compulsory copyright license which permits it to retransmit the programming of any broadcast television station, without prior consent from copyright holders and without negotiating fair compensation for those rights. In contrast, KWHB must pay market prices for its programming, and it does not enjoy any subsidy of its programming costs.

In sum, at the present time, Tulsa Cable competes with KWHB, a local independent specialty station, for both programming sources, advertisers, and audience for religious programming in the Tulsa market. Tulsa Cable uses its monopoly bottleneck facility unfairly to discriminate against its competitor, KWHB. Tulsa Cable limits KWHB's ability to compete with its religious channel and with other television stations in the Tulsa market by refusing to carry KWHB on any terms, and thereby abuses its monopoly power. At the same time, Tulsa Cable enjoys a subsidy of its programming costs at the expense of copyright holders. If the current situation continues, KWHB will likely not survive economically in the Tulsa television marketplace.

The anti-competitive conditions in Tulsa, Oklahoma are not unique, but are merely illustrative of a climate which exists in many markets of varying sizes throughout the nation. There are two significant trends in cable television industry which will continue to drive this anti-competitive situation on a national level. First, the nation's MSO's continue to grow by acquiring each other and individual cable systems, apparently without any governmental attention. Second, the largest MSO's are permitted to have growing financial interests in various programming sources. As the large MSO's such as TCI and United Cable, soon to be UAE, increase their ownership interests in, or joint ventures with, programming companies such as Cable Value Network, American Movie Classics, Black Entertainment Television, the Discovery Channel, Event-Television (the new pay-per-view service), and the like, there will be even greater incentives for cable systems to abuse their monopoly power as gatekeepers of bottleneck facilities and to discriminate against local broadcast television stations, particularly independent specialty stations, using the method in which Tulsa Cable is now engaged — freezing out the competing broadcast station by absolutely denying it carriage on the cable system.

Thank you for the Subcommittee's attention, and your interest in this matter.

Sincerely,

Peter Sumrall

Peter Sumrall
LeSea Broadcasting, Inc.

Senator METZENBAUM. Hearing stands adjourned.

[Whereupon, at 12:03 p.m., the subcommittee hearing was concluded.]

# APPENDIX

## ADDITIONAL SUBMISSIONS FOR THE RECORD

Coaxial
Communications
Technology and Service through Cable Television

**Executive Offices**

March 22, 1988

Senator Howard Metzenbaum
1240 East 9th Street
Cleveland, Ohio 44199

Dear Senator Metzenbaum:

My name is Joel S. Rudich. I am the President and Chief Operating Officer of Coaxial Communications. Coaxial is an Ohio based cable television company employing approximately 300 people and servicing approximately 75,000 households in the Columbus and Cincinnati metropolitan areas.

On Thursday, March 17, 1988, you chaired a public hearing that dealt with several cable issues. One of these issues dealt with the carriage of independent broadcast signals on cable systems, and one of the panelists, Mr. Wendell Triplett, General Manager, WWAT-TV53, Chillicothe, Ohio, used this forum to unfairly disparage the name of our company, Coaxial Communications.

Unfortunately, Mr. Triplett misstated the facts regarding his signal not being carried on Coaxial's Columbus, Ohio cable system. Because Mr. Triplett's statements are so overwhelmingly inaccurate, I hereby request the opportunity to set the record straight since the Committee did not hear the real facts. I respectfully request that this letter and attachments be included in the record of the hearing.

In his testimony, Mr. Triplett dwelt on his investment in his new UHF broadcast station. Yet, at the same time, Coaxial made a major investment and took a sizeable risk to offer new local Columbus oriented programming and minority and special interest programming.

During 1986/1987, Coaxial spent several million dollars to expand the capacity of its Columbus system by adding five additional channels. At that time, it was our plan to add the following additional programming during the fall of 1988: The Discovery Channel, Black Entertainment Network, The Weather Channel, Electronic Program Guide and "Coax 36", a composite program channel including local Columbus area high school, college and professional sports. Contract negotiations with all these program suppliers had begun well before the anticipated 1987 fall launch of these new services.

While we were finalizing our fall marketing plans, we were formally notified by Mr. Triplett that his new station, WWAT-TV53, Chillicothe, which, as you know, is located approximately 50 miles south of Columbus, was a "must-carry" station and demanded carriage on our cable system. At that time, acting in good faith, we took Mr. Triplett at his word that, in fact, WWAT-TV53 was a "must-carry" signal even though they were not a "local" Columbus signal and their programming was nothing more than 24 hours a day of shopping from America's Value Network. We began carrying WWAT as part of the Basic Service on our cable system on October 1, 1987.

In December, 1987, when the U.S. Appeals Court overturned the "must-carry" rules, I personally contacted the local broadcast stations (both VHF and UHF) and informed them that, despite the court's decision, Coaxial had no plans to make any changes to our channel line-ups that would adversely affect them in any manner whatsoever. Indeed, we continued to carry TV53 into 1988.

However, on January 20, 1988, Coaxial was informed by its FCC counsel that, contrary to Mr. Triplett's claims, WWAT-TV53 was not, and had never been a must-carry signal under the FCC rules. In fact, carriage of WWAT would cause Coaxial to incur significant potential copyright liability which could range between $180,000 and $700,000 per year since WWAT-TV53 was a "distant" signal under the cable copyright law.

Upon learning of WWAT-TV53's erroneous representations, Coaxial dropped WWAT from carriage on its cable system; and, we informed Mr. Triplett, in writing, of the financial exposure to Coaxial. Mr. Triplett then advised Coaxial that Channel 53 would assume total copyright liability. However, his assumptions as to the copyright fees grossly underestimated the amount that Coaxial would be liable for.

Since that time, Coaxial Communications has made repeated attempts to have Mr. Triplett clarify his assumption of copyright liability. Contrary to Mr. Triplett's testimony that WWAT would cooperate fully to protect Coaxial the attached letters from me to WWAT-TV53 clearly show that this statement is absolutely inaccurate. These letters represent only a few of the unanswered letters sent to WWAT-TV53 seeking clarification.

Senator Metzenbaum, as you know, the copyright laws specify that the carriage of any distant signal (regardless of whether it is for one minute or for one month in any six-month accounting period) imposes significant copyright liability on a cable company. As a result of this law, the carriage of WWAT would impose a minimum $180,000 annual increase in copyright liability. As Coaxial grows, this payment could increase to approximately $700,000 annually. Thus, it is critical that we obtain from Mr. Triplett guarantees that he would make specific arrangements to deposit the funds reimbursing us for this expense incurred solely due to the carriage of WWAT. Coaxial will suffer this huge liability from the carriage of WWAT-TV53 regardless of whether Mr. Triplett is unable to reimburse us after carriage is instituted. We have simply requested Mr. Triplett insure that the station pay these costs. But, contrary to his testimony, the attached letters clearly show that Mr. Triplett acknowledges the copyright liability that WWAT-TV53 would impose on Coaxial and that he has refused to respond to this issue.

To the extent Mr. Triplett got bad advice regarding WWAT-TV53's must-carry status in Columbus, the bottom line is that TV53 was never a must-carry signal under FCC rules. In fact, WWAT-TV53, as a distant station under the copyright law, imposed major potential copyright liability on Columbus cable systems. Having relied on Mr. Triplett's earlier erroneous statements regarding his must-carry status, Coaxial now wants more than empty, ambiguous and unenforceable statements that the station will take care of us.

In summary:

1) WWAT is not and has never been a must-carry signal for Coaxial Communications.

2) Carriage of WWAT by Coaxial Communications would create a copyright liability of $180,000 to $700,000 for Coaxial.

3) Mr. Triplett has continually refused to respond to Coaxial's request regarding insuring Coaxial protection from the copyright liability related to WWAT's carriage.

4) Coaxial currently carries all local signals carried under the recently overturned must-carry rules and we have no plans to do otherwise. I personally contacted these local stations in December, 1987 and informed them of this fact.

Senator Metzenbaum, I trust this provides both sides of the story regarding the signal carriage of WWAT on Coaxial's Columbus, Ohio cable system. Mr. Triplett hoped to guarantee his success in the broadcast business based on his Chillocothe signal being carried on the Columbus cable systems 50 miles away regardless of the nature of the copyright laws. He did not fully understand the laws regarding cable's copyright liability in carrying distant independent signals. As such, it is not accurate to blame Coaxial for Mr. Triplett's mistake. Coaxial has acted in complete good faith in its efforts to accommodate the carriage of WWAT.

I look forward to meeting with you on your next visit back home to either Cleveland or Columbus. In the meantime, if I can be of any further assistance to you on this matter, please let me know.

Sincerely,

Joel S. Rudich
President and
Chief Operating Officer

/gg

Enclosures

cc: Preston Padden, President, INTV

Channel 53 Television
CHILLICOTHE / COLUMBUS

[redacted]

Jcel Rudich
Coaxial Communications
3770 East Livingston Avenue
Columbus, Ohio 43227

Dear Mr. Rudich,

This is to notify you that WWAT-TV channel 53 signed on Monday August 31, 1987. The Broadcast License is on Chillicothe, Ohio which means that channel 53 is a must carry station in the Columbus market. (Coaxial headend is well within 50 mile limit of must carry).

We are officially requesting that you add us to your system. In accordance with our meeting of October 29, it was agreed that Coaxial would commence carrying channel 53 on Monday November 2, 1987.

I look forward to working with you to give central Ohio viewers the best possible programming.

Sincerely,

Terry Penrod

Terry Penrod
Program/National Sales Manager

TP/lj

2698 Sawbury Blvd. • Worthington, Ohio 43085 • 614-766-9603

Coaxial
Communications
Technology and Service through Cable Television

**Executive Offices**

[redacted]

Mr. Wendell A. Triplett
General Manager
WWAT-TV
2698 Sawbury Blvd.
Worthington, OH 43085

Dear Mr. Triplett:

We understand that Channel 53 (WWAT) is currently switching from a primarily home shopping format to a significant amount of regular programming. Under the must carry rules recently in effect, Coaxial was obligated to carry Channel 53. These same rules, however, excuse Coaxial from carrying any signal if such carriage would subject Coaxial to additional copyright liability. Since Channel 53 would not be a must carry under the 1976 rules (the rules to which copyright liability is tied) Channel 53 is a distant signal to Coaxial.

Since Channel 53 (WWAT) is going to a non-specialty format, and since Coaxial already carries more than its quota of independent signals, carriage of Channel 53 would cost Coaxial the maximum copyright liability - 3.75% of gross non-premium revenues. In light of this additional burden, Coaxial will delete the carriage of Channel 53 (WWAT) effective immediately.

Sincerely,

Joel S. Rudich
President and
Chief Operating Officer

/gg

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Technology and Service through Cable Television

**Executive Offices**

[redacted]

file

Mr. Terry Penrod
~~Program~~/National Sales Manager
~~Channel 53 Tele~~vision
2698 Sawbury Boulevard
Worthington, OH 43085

Dear Mr. Penrod:

Thank you for your letter of January 27, 1988 in which you propose to reimburse Coaxial for both annual copyright and marketing promotional costs.

While this is certainly an interesting proposal, I believe that you have made a significant miscalculation in the computation of potential copyright liability as noted in Appendix 1, Item A as $50,528. I believe you have failed to recognize that copyright is an annual liability and could go as high as $650,000 under the current rate structure. I think it should now be clear to you the impact copyright liability has on the decision process regarding the carriage of WWAT.

With regard to the use of Channel 53 for promotional advertising, the total value that you have assigned to items B and C are imputed based on your assessment, and do not correspond to value that we would place on them. Unless, of course, you are offering us this amount for us to use on TV advertising as we see appropriate consistent with our overall marketing plans to increase our cable penetration.

As you can see our decision not to carry WWAT is based on our recognition as well as the FCC's which recognizes that copyright liability justifies the action we have taken particularly when the programming mix does not dictate otherwise.

Sincerely,

Joel S. Rudich
President and
Chief Operating Officer

/gg

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Executive Offices

[redacted]

Mr. Donald S. Berman
General Sales Manager
Channel 53 Television
2698 Sawbury Blvd.
Columbus, OH 43235

Dear Mr. Berman:

This letter is a follow-up to our telephone conversation today which was in response to your letter of February 16, 1988.

As I mentioned to you, the specific purpose of my call was to obtain a clarification of item "1" in your letter "WWAT-TV53 will assume total copyright liability." On January 27, 1988, Mr. Terry Penrod wrote to me with the exact same proposal. On January 28, 1988, I responded in writing to Mr. Penrod and requested that he clarify his proposal which stated "WWAT-TV53 will assume total copyright liability." As of this date, Mr. Penrod has not responded to me.

The question remains, what do you mean by this statement? We estimate that the current liability that we would incur if we carried WWAT to be approximately $180,000 per year and that this could go as high as $700,000 per year as our system expands beyond the Grade B contour.

You have stated to me that you will make this payment. However, full liability for each six-month period is incurred the moment we carry one program from TV53 and cannot be avoided if we drop TV53 for failure to meet its commitment to Coaxial. Thus, we would request that a sufficient escrow account be established by WWAT prior to our carriage of TV53 to cover 1) the current six-month period's liability, and 2) that funds be deposited thirty (30) days in advance of each upcoming copyright period. Since you were not prepared to commit to providing the funds concurrent with Coaxial liability, it was agreed that you would have Mr. Triplett respond to me in writing with his reply.

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We believe this requirement is crucial to protecting Coaxial against enormous liability should carriage of TV53 be undertaken as a non-must carry signal. Indeed, I believe that Coaxial acted in good faith from the very beginning. In October, 1987, we accepted WWAT's representation that they were, in fact, a must carry signal. In fact, WWAT was not and has never been a must carry signal for Coaxial and, as a result of our acceptance of your verbal representation, we have suffered significant copyright liability. I do not intend to ever allow this to happen again. Thus, we are attempting to document all of our discussions so that no one can be unfairly accused of acting unfairly.

Coaxial currently carries all local signals required under the recently overturned must carry rules and we have no plans to do otherwise. I personally contacted these local stations in December, 1987 and informed them of this fact.

I look forward to your written reply.

Sincerely,

Joel S. Rudich
President and
Chief Operating Officer

/gg

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Communications
Technology and Service through Cable Television

**Executive Offices**

[redacted]

Mr. Terry Penrod
Program/National Sales Manager
Channel 53 Television
2698 Sawbury Boulevard
Columbus, OH 43235

Dear Mr. Penrod:

Thank you for your letter of February 24, 1988 in which you request that our attorneys contact Mr. Perkins, your Washington attorney "to construct an agreement that will answer the copyright issue".

I'm not quite sure that I understand this current request. The copyright issue is clearly spelled out by the FCC and I don't believe that I need to incur additional legal expense to "construct an agreement" that already is part of the law.

I am also quite concerned about the approach you (WWAT) are taking in this matter. I responded to your letter of January 27, 1988 on January 28, 1988. I still have not received a reply to my letter.

On February 12, 1988 Mr. Donald Berman, General Sales Manager for WWAT, called my office to inform me of a "new" proposal he had for Coaxial to consider. He wrote to me on February 16, 1988 with this "new" proposal which turned out to be the exact same proposal you made to me on January 27th. I called Mr. Berman on February 18, 1988 to discuss his proposal, and; interestingly enough, he said that he was totally unaware of your letter! I asked Mr. Berman if he could clarify his and your proposal "WWAT-TV53 will assume total copyright liability"? His response was that WWAT was prepared to pay our total copyright liability, but, he didn't know how much money was involved. When I told him that it could range between $180,000 and $700,000 per year and that we would require that this liability would have to be placed in an escrow account to protect Coaxial against enormous financial copyright liability, Mr. Berman then said

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that only Mr. Triplett could respond to this issue. He informed me that Mr. Triplett was out of town, but would return the next day with an answer. It is now a week later and I have not heard from Mr. Triplett.

Mr. Penrod, I think it is about time that you begin to represent the issues involved in this case in a full and forthright manner. WWAT was not and has never been a must carry signal for Coaxial and, as a result of our good faith acceptance of your verbal representation, we have potential significant copyright liability.

It is regrettable that you entered the broadcast business without having fully understood both the must carry and copyright rules - but, that is not Coaxial's fault. It is also regrettable that you continue to attempt to gain media attention without fully stating all the facts. This approach has caused Coaxial to spend enormous amounts of its management time plus the incurrence of substantial legal fees. In the same regard, Coaxial is formally requesting that you immediately cease from including our name in your newspaper and TV Guide advertisements indicating that WWAT is carried on Coaxial's Channel 19 since these ads are false and misleading.

Although I have tried to respond to WWAT's requests in a timely manner, it appears that you have several different agendas with regard to this issue depending on your "audience". Therefore, I am advising you that I will no longer respond to any more of your letters and/or requests until you formally acknowledge in writing that (1) you are not and have never been a must carry signal for Coaxial, and that your written request dated October 30, 1987 informing Coaxial that WWAT was a must carry signal and requesting addition to our system was improper, and, (2) you are fully prepared to cover our copyright liability by placing in escrow the total amounts of funds that Coaxial could be required to pay.

Coaxial currently carries all local signals carried under the recently overturned must carry rules and we have no plans to do otherwise. I personally contacted these local stations in December, 1987 and informed them of this fact.

I look forward to your written reply.

Sincerely,

Joel S. Rudich
President and Chief Operating Officer

/gg

cc: Mayor Rinehart, City of Columbus

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Communications
Technology and Service through Cable Television

Executive Offices

[redacted]

Mr. Wendell Triplett
CEO/General Manager
Channel 53 Television
2698 Sawbury Blvd.
Columbus, OH 43235

Dear Mr. Triplett:

I am in receipt of your letter dated March 8, 1988. It is indeed regretable that you continue to respond to the signal carriage issue in the manner you have chosen. As you know, your Washington attorney, Mr. Roy Perkins, talked with our attorney and Mr. Perkins acknowledged that WWAT was never a must carry signal.

However, the question still remains, "How do you propose to deal with the copyright liability issue that Coaxial would be faced with by carrying Channel 53?" This question has been raised in correspondence with Channel 53 dated January 20, 26, 28, February 12, 16, 18, 24, and 25, 1988 - and, still we have no reply from you.

As I have stated in the past, Coaxial currently carries all local signals carried under the recently overturned must carry rules and we have no plans to do otherwise. I personally contacted these local stations in December, 1987 and informed them of this fact.

Sincerely,

Joel S. Rudich
President and
Chief Operating Officer

/gg

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cpb CORPORATION FOR PUBLIC BROADCASTING

Donald E. Ledwig
President and
Chief Executive Officer

April 8, 1988

Honorable Howard Metzenbaum
Chairman, Subcommittee on
Antitrust, Monopolies and Business Rights
Committee on Judiciary
United States Senate
308 Hart Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

Please include in the Record of your recent hearing on cable television the views of the Corporation for Public Broadcasting (CPB) on the issue of assured cable carriage of local public television stations.

Public television applauds your decision to conduct this hearing on the problems and policy dilemmas resulting from the growth of cable television service in the United States. Without a doubt, cable has revolutionized the electronic mass media, but the revolution has been a mixed blessing for the American people. Indeed, through cable, multiple and diverse video services and programming are now available to millions of viewers. However, the drastic regulatory changes that were made to accommodate cable's explosive growth may severely reduce the availability of a vital public service that should be universally available to all Americans: public television.

1111 16th Street NW
Washington, DC 20036
(202) 955-5275

## Public Television Provides Americans The Finest Quality Programs Available--For Free

Public television provides the American people the highest quality and most diverse programming available without charge on television today. Over ninety million Americans tune in to public television every week for the in-depth news coverage of MacNeil/Lehrer NewsHour; the hardhitting documentaries of Frontline; the original American drama from American Playhouse; live opera, ballet and symphony concerts on Great Performances and Live From Lincoln Center; the only high-quality educational programming available for our children, such as Sesame Street, Square One TV, and Three-Two-One Contact; and for a myriad of other diverse and stimulating programs. Quite simply, public television challenges Americans to be citizens, thinkers, and achievers, not just consumers. Moreover, public television is available over the air, free to all citizens, not just to those who are wired and can afford to pay for cable service.

However, as a result of a regulatory and judicial process that has stood the public interest on its head, millions of American viewers could be denied these important public television benefits which they, through their taxes, have helped finance. Loss of assured carriage on cable will harm the public television system in several ways.

### Carriage Loss Reduces Program Diversity

Without mandatory carriage, there is no guarantee that cable systems will carry even one local public television station. Instead, if they decide to carry any public television station at all, they could opt for a distant, larger, more powerful public television station. Even if they carry one local public television station, however, they will likely not carry a second or third local public television station, on the assumption that only the programming fed by PBS needs to be included on the cable. This assumption ignores the plethora of educational programming geared to the local community that is provided by public television stations throughout the day, as well as the wealth of regional programming not distributed through PBS. Such programming differs greatly from station to station within the local market. Thus, without mandatory cable carriage, there will be a severe reduction in the diversity of programming available through public television stations to the American people.

### Carriage Loss Undermines Public Television's Revenue Base

Each public television station that loses cable carriage suffers a loss in audience and viewer contributions, which reduces the ability of that station to acquire programming to serve its community. This loss of carriage of individual stations exerts a cumulative drag on the ability of the system to finance production of new and innovative programming, because public television funds many of its programs collectively through such mechanisms as the Station Program Cooperative and the Program Challenge Fund. Thus, carriage loss not only harms each individual station that is dropped, but also harms the overall public television system.

### Carriage Loss Could Jeopardize Congressional Policy of Federal Financing For Public Television

Finally, loss of cable carriage could harm the public broadcasting system in an indirect but very important manner. The Public Broadcasting Act authorizes financing for public broadcasting stations on the basis of a matching formula of nonfederal to federal financing. Today, public television stations exceed their matching requirement to receive the full amount of funds authorized by the Act. However, if enough stations suffered a substantial reduction in their contributions as a result of loss of carriage on their local cable systems, the overall amount of federal financing intended by Congress to be available to public broadcasting could be reduced.

As President of the only public broadcasting organization statutorily accountable to Congress for the welfare and performance of the public broadcasting system, I feel obligated to inform the Subcommittee of the serious impact that loss of assured cable carriage will have on the public television system.

I appreciate the opportunity to include this letter in the Record of your hearing on cable-antitrust issues. I would be happy to elaborate on the implications of cable carriage loss for public television in any follow-up hearing you conduct.

Thank you for the strong support you have provided public broadcasting over the years and for the Congressional attention you are focusing on this serious problem facing public television.

Sincerely,

Donald Ledwig

Donald Ledwig
President and
Chief Executive Officer